

**NOTE TO IAASB**

This draft of the Introduction and Requirements section is a working document at the moment. It is included here to give the Board an indication of the Task Force's current thinking about the flow and coverage of the ISAE. It is subject to change based on the IAASB's decisions on matters raised in the Issues Paper.

**INTERNATIONAL STANDARD ON ASSURANCE ENGAGEMENTS 3402****Assurance Reports on a Service Organization's Controls****Introduction****Scope of this ISA**

1. This International Standard on Assurance Engagements (ISAE) deals with assurance reports on a service organization's controls. In certain circumstances, the auditors of user entities, as described in [proposed] International Standards on Auditing (ISA) 402 (Revised and Redrafted), "Audit Considerations Relating to an Entity Using a Service Organization" may decide to use such reports as audit evidence.
2. This ISAE applies to assurance engagements to report on the controls of an organization that provides a service to user entities when the service organization considers those controls are likely to be part of user entities' information systems, including the related business processes, relevant to financial reporting. It may also be applied, adapted as necessary in the circumstances of the engagement, for engagements to report on other controls at a service organization.
3. As noted in [proposed] ISA 402 (Revised and Redrafted), a service organization's controls are part of one or more user entities' information systems, including the related business processes, relevant to financial reporting if they affect any of the following:
  - (a) The classes of transactions in user entities' operations that are significant to user entities' financial statements;
  - (b) The procedures, both automated and manual, by which user entities' transactions are initiated, authorized, recorded, processed and reported from their occurrence to their inclusion in user entities' financial statements;
  - (c) The related accounting records, whether electronic or manual, supporting information and specific accounts in user entities' financial statements involved in initiating, authorizing, recording, processing and reporting user entities' transactions;
  - (d) How user entities' information systems capture other events and conditions that are significant to user entities' financial statements; or
  - (e) The financial reporting processes used to prepare user entities' financial statements, including significant accounting estimates and disclosures.
4. In addition to issuing an assurance report on controls, a service auditor may also be engaged to provide the following reports which are not dealt with in this ISAE:

- (a) An assurance report on a user entity's transactions or balances maintained by the service organization; or
  - (b) An agreed-upon procedures report on controls at a service organization, or on a user entity's transactions or balances maintained by the service organization.
- 5. This ISAE is written in terms of third-party service organizations which are not related to the applicable user entities, but may also be applicable, adapted as necessary in the circumstances of the engagement, to a shared service center which provides services to a group of related entities.
- 6. The "International Framework for Assurance Engagements" (the Assurance Framework) notes that an assurance engagement may be either an "assertion-based" engagement or a "direct reporting" engagement. This ISAE is written in terms of an assertion-based engagement as this appropriately reflects the accountability relationship between the service organization and the user entity.

*Relationship with other professional pronouncements*

- 7. When preparing an assurance report on a service organization's controls that are part of user entities' information systems relevant to financial reporting, the service auditor is required by paragraph 14 of this ISAE to comply with ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information," in addition to this ISAE. The Assurance Framework, which defines and describes the elements and objectives of an assurance engagement, provides the context for understanding this ISAE and ISAE 3000.
- 8. Compliance with ISAE 3000 requires, amongst other things, that the service auditor comply with the Code of Ethics for Professional Accountants (the Code), and implement quality control procedures that are applicable to the individual engagement.
- 9. Although ISAs do not apply to engagements covered by ISAEs, [proposed] ISA 402 (Revised and Redrafted) deals with the responsibilities of user auditors to obtain sufficient appropriate audit evidence when a user entity uses one or more service organizations that perform services that are part of the entity's information system relevant to financial reporting, and provides guidance to user auditors in using an assurance report on controls at a service organization.

*Service Organization Responsibilities*

- 10. The service organization's responsibilities relevant to a service auditor's engagement to issue a report on the service organization's controls include:
  - (a) Providing the services covered by the description of controls and control objectives;
  - (b) Identifying the control objectives and the risks that threaten their achievement;
  - (c) Designing, implementing and maintaining controls to achieve the identified control objectives, and the operating effectiveness of those controls;
  - (d) The completeness, accuracy and method of presentation of the description of controls and control objectives; and

- (e) When the service organization has engaged the service auditor, agreeing terms of reference with the service auditor.

### Effective Date

- 11. This ISAE is effective for assurance reports dated on or after [date].

### Objective

- 12. The objectives of the service auditor are to:
  - (a) Obtain reasonable assurance about whether:
    - (i) Management's description of controls and control objectives is fairly presented in all material respects;
    - (ii) The controls are suitably designed to provide reasonable assurance that the specified control objectives will be achieved if the controls operate effectively;
    - (iii) The controls are in existence as at a specified date; and
    - (iv) In the case of a Type B report, the controls operated effectively throughout a specified period; and
  - (b) Report in accordance with the service auditor's findings.

### Definitions

- 13. For purposes of this ISAE, the following terms have the meanings attributed below:
  - (a) User entity – An entity that uses a service organization that performs services that are part of the entity's information system relevant to financial reporting.
  - (b) User auditor – An auditor who audits and reports on the financial statements of the user entity.
  - (c) Service organization – An organization (or segment of an organization) that provides services to user entities that are part of a user entity's information system relevant to financial reporting.
  - (d) Service auditor – The auditor who provides an assurance report on a service organization's controls.
  - (e) Service organization's controls – Those controls at the service organization that relate to the services considered by the service organization to be part of user entities' information systems relevant to financial reporting and which are covered by the service auditor's report. (Ref: Para. Axx)

For the Application Material section:

Axx. While the definition of "service organization's controls" at paragraph 13 (e) focuses on the information systems component of user entities' internal control, and invariably includes aspects of the services provided by the service organization that represent aspects of the user entity's information system maintained by the service organization, it may also include aspects of one or more of the other components of internal control. For example, it may include aspects of the service organization's control environment, monitoring, and control activities where they relate to the

services provided that are part of the user entities' information systems. It does not, however, include controls at a service organization that are not related to user entities' information systems, e.g. controls related to the preparation of the service organization's own financial statements. See ISA 315 (Redrafted), "Identifying and Assessing Risks of Material Misstatement Through Understanding the Entity and Its Environment" for a definition and discussion of internal control, and "controls" as they relate to a financial statement audit, including a discussion of the information system relevant to financial reporting.

- (f) Control objectives – The aim or purpose of a particular aspect of the service organization's controls. Control objectives ordinarily relate to risks that controls seek to mitigate. Examples of control objectives are provided in Appendix 1.
- (g) Complementary user entity controls – Controls that the service organization assumes, in the design of its service, will be implemented by user entities.
- (h) Report on the description, design and existence of controls at a service organization (referred to in this ISAE as a Type A report) – A report that comprises:
  - (i) A description of controls and control objectives prepared by management of the service organization;
  - (ii) A written assertion by the service organization's management that:
    - (a) The description of controls and control objectives presents fairly, in all material respects, the relevant aspects of the service organization's controls that had been implemented as at a specified date;
    - (b) The controls are suitably designed to provide reasonable assurance that the specified control objectives will be achieved if the controls operate effectively; and
    - (c) The controls were in existence as at a specified date; and
  - (iii) An assurance report that includes the service auditor's opinion about the matters in (ii)(a) – (ii)(c) above.
- (i) Report on the description, design, existence and effective operation of controls at a service organization (referred to in this ISAE as a Type B report) – A report that comprises:
  - (i) A description of controls and control objectives prepared by management of the service organization;
  - (ii) A written assertion by the service organization's management that:
    - (a) The description of controls and control objectives presents fairly, in all material respects, the relevant aspects of the service organization's controls that had been implemented throughout a specified period;
    - (b) The controls are suitably designed to provide reasonable assurance that the specified control objectives will be achieved if the controls operate effectively;
    - (c) The controls were in existence throughout a specified period; and
    - (d) The controls operated effectively throughout a specified period; and

- (iii) An assurance report that includes:
  - (a) The service auditor's opinion about the matters in (ii)(a) – (ii)(d) above; and
  - (b) A description of the service auditor's tests of the controls and the results thereof.
- (k) Subservice organization – A service organization used by another service organization to perform some or all of the services provided to a user entity that are part of a user entity's information system relevant to financial reporting..
- (l) Subservice organization's controls – Those controls at the subservice organization that relate to the services covered by the service auditor's engagement which the service organization considers to be part of user entities' information systems relevant to financial reporting.
- (m) The inclusive method – Method of dealing with the services provided by a subservice organization, whereby the subservice organization's relevant control objectives and related controls are included in the service organization's description of controls, and in the scope of the service auditor's engagement.
- (n) The carve-out method – Method of dealing with the services provided by a subservice organization, whereby the subservice organization's relevant control objectives and related controls are excluded from the service organization's description of controls, and from the scope of the service auditor's engagement. The service organization's description of controls, and the scope of the service auditor's engagement do, however, include controls at the service organization to monitor the effectiveness of controls at the subservice organization, which may include the service organization's review of a Type A or Type B report on controls at the subservice organization.

## **Requirements**

### **ISAE 3000 and Ethical Requirements**

- 14. In addition to this ISAE, the service auditor shall comply with ISAE 3000, which includes compliance with the Code. Although the service auditor is required by the Code to be independent from the service organization in order to perform an engagement in accordance with ISAE 3402, the service auditor is not required to be independent from each user entity.

### **Agreeing on the Terms of the Engagement**

- 15. Before agreeing on the terms of the engagement, the service auditor shall be satisfied that the description of controls included in the scope of the engagement is not so limited that it is unlikely that the engagement has a rational purpose.
- 16. The auditor shall consider the appropriateness of a request to change the scope of the engagement, and should not agree to a change without reasonable justification.

### **Using the Work of Others**

- 17. When the service auditor uses the work of others, the service auditor shall:

- (a) Consider the provisions of [proposed] ISA 610 (Redrafted), "The Auditor's Consideration of the Internal Audit Function," or [proposed] ISA 620 (Revised and Redrafted), "Using the Work of an Auditor's Expert as Audit Evidence;" and
- (b) Not make reference to such work in the section of the assurance report that contains the service auditor's opinion. In the case of a Type B report, however, if internal audit or an expert is used in performing tests of controls, reference shall be made in the section of the assurance report that describes the service auditor's tests of the controls and the results thereof.

## Obtaining Evidence

### *Description of Controls and Control Objectives*

- 18. The service auditor shall obtain sufficient appropriate audit evidence about whether the service organization's description of controls and control objectives presents fairly, in all material respects, the service organization's controls that had been implemented as at a specified date. This shall include whether the description adequately describes controls that the service organization assumes, in the design of its service, will be implemented by user entities (complementary user entity controls).
- 19. If relevant services are performed by a subservice organization, the service auditor shall evaluate whether the description adequately identifies (a) those services, and (b) whether the subservice organization's controls and related control objectives are included in or excluded from the description. If the subservice organization's control objectives and related controls are included in the description, the service auditor shall evaluate whether the description clearly differentiates between the service organization's controls and the subservice organization's controls.

For the Application Material:

A brief discussion of subservice organizations will be included, noting that the terms of reference should refer to the service auditor's responsibilities with respect to subservice organizations. Application material may further describe how the service auditor might apply the inclusive method. For example, it may address how the service auditor may use a report on controls from subservice organizations in evaluating whether controls are fairly described, suitably designed, exist and operating effectively. In such cases, the guidance in [proposed] ISA 402 (Revised and Redrafted) may assist the service auditor in evaluating the sufficiency and appropriateness of such reports as evidence.

### *Design of controls*

- 20. The service auditor shall evaluate whether the service organization's controls were suitably designed to achieve the specified control objectives. This shall include:
  - (a) Evaluating whether the service organization has identified relevant control objectives;
  - (b) Identifying the risks that threaten the achievement of those objectives; and
  - (c) Evaluating the linkage of the controls identified in the description to their related control objectives.

*Existence of controls*

21. The service auditor shall determine whether the service organization's controls existed at relevant times during the period under audit by performing procedures that include:
  - (a) Inquiry of appropriate service organization personnel;
  - (b) Inspection of service organization documents and records; and
  - (c) Observation of service organization activities and operations.

*Effectiveness of controls*

22. Paragraphs ~~23–27~~ apply only when the service auditor is providing a Type B report.
23. The service auditor shall determine which of the service organization's controls are necessary to achieve the specified control objectives (i.e. relevant controls).
24. The service auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls.
25. In designing and performing tests of relevant controls, the service auditor shall:
  - (a) Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of relevant controls, including:
    - (i) How the controls were applied.
    - (ii) The consistency with which they were applied.
    - (iii) By whom or by what means they were applied.
  - (b) Determine whether relevant controls to be tested depend upon other controls (indirect controls), and if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls; and
  - (c) Determine the extent of tests of controls taking account of factors that include the nature of relevant controls, the frequency of their application (e.g., monthly, daily, many times per day), and the expected rate of deviation.
26. The service auditor shall test relevant controls to obtain sufficient appropriate audit evidence of their operating effectiveness throughout the period covered by the report.
27. When deviations from relevant controls are detected, the service auditor shall evaluate the nature and number of the deviations and their potential consequences, and determine whether:
  - (a) The results of tests of controls that have been performed provide an appropriate basis for concluding that relevant controls are operating effectively even though exceptions were identified;
  - (b) Additional tests of controls are necessary to reach a conclusion on whether the controls are operating effectively; or
  - (c) The tests of controls that have been performed provide an appropriate basis for concluding that relevant controls did not operated effectively throughout the specified period.

*Representations by the Responsible Party*

28. The service auditor shall request management of the service organization to provide written representations that it acknowledges and understands its responsibility for the matters noted in paragraph 10, and that it has disclosed to the service auditor any of the following of which it is aware:
- (a) Illegal acts, fraud or uncorrected errors attributable to the service organization's management or employees that may affect one or more user entities;
  - (b) Design deficiencies in controls, including those for which management believes the cost of corrective action may exceed the benefits;
  - (c) Instances where controls have not operated with sufficient effectiveness to achieve the specified control objectives; and
  - (d) Subsequent events that would have a significant effect on user organizations.
29. The service auditor shall request management to provide a written representation whether they believe that all records, documentation, unusual matters of which they are aware, and other information relevant to the assurance engagement have been made available to the service auditor.
30. The written representations noted in paragraphs 28 and 29 shall be in the form of a representation letter addressed to the service auditor, and shall be as of the same date as the service auditor's assurance report.

For the Application Material:

The application material will note that these representations are separate from, and in addition to the assertion contained in the report on controls, as described in paragraph 13 (h) (ii) for a Type A report, and paragraph 13 (i) (ii) for a Type B report.

*Other Information*

31. The service auditor shall read other information included in a document containing the report on controls at the service organization that is provided to user entities on the same terms and at the same time as the report on controls, to identify material inconsistencies with that report.

**Documentation**

32. The service auditor shall prepare documentation so as to enable an experienced service auditor, having no previous connection with the audit, to understand:
- (a) The nature, timing, and extent of the procedures performed to comply with this ISAE, and applicable legal and regulatory requirements;
  - (b) The results of the procedures, and the evidence obtained; and
  - (c) Significant matters arising during the engagement, and the conclusions reached thereon.
33. In documenting the nature, timing and extent of audit procedures performed, the service auditor shall record:



- (a) The identifying characteristics of the specific items or matters being tested;
  - (b) Who performed the procedures and the date such procedures were completed; and
  - (c) Who reviewed the work performed and the date and extent of such review.
34. The service auditor shall document discussions of significant matters with the service organization and others on a timely basis.
35. If the service auditor has identified information that contradicts or is inconsistent with the service auditor's final conclusion regarding a significant matter, the service auditor shall document how the service auditor addressed the contradiction or inconsistency in forming the final conclusion.

## **Preparing the Assurance Report**

### *Assurance Report Content*

36. The assurance report shall include a section with the following basic elements:
- (a) A title that clearly indicates the report is an independent assurance report.
  - (b) An addressee.
  - (c) An identification of:
    - (i) The description of controls and control objectives prepared by management of the service organization, which includes an identification of the services covered by the description and the period to which the description relates
    - (ii) When parts of the description of controls and control objectives prepared by management of the service organization are not covered by the service auditor's opinion, an identification of those parts;
    - (iii) Management's assertion, which includes the matters described in paragraph 13 (h) (ii) for a Type A report or paragraph 13 (i) (ii) for a Type B report, and a statement that the auditor has audited that assertion.
    - (iv) Where appropriate, the fact that the service auditor has not evaluated the operating effectiveness of complementary user entity controls, and that if complementary user entity controls are not operating effectively, the service organization's controls may not achieve the specified objectives; and
    - (v) Where appropriate, that fact that the description of controls and control objectives prepared by management of the service organization excludes the control objectives and related controls of relevant subservice organizations, and that the service auditor's procedures do not extend to the subservice organization.
  - (d) An identification of the party specifying the control objectives.
  - (e) A statement that:
    - (i) The potential operating effectiveness of controls at the service organization is subject to inherent limitations and, accordingly, errors or fraud may occur and not be detected; and
    - (ii) The historic evaluation of the operating effectiveness of controls is not relevant to future periods due to the risk that they may become inadequate

because of changes in conditions, or that the degree of compliance with them may deteriorate;

- (f) Identification of the intended users;
  - (g) A description of the service organization's and the service auditor's responsibilities, including a reference to the content of management's written assertion, and a statement that the service organization is responsible for:
    - (i) The completeness, accuracy and method of presentation of the description of controls and control objectives;
    - (ii) The services covered by the description of controls and control objectives; and
    - (iii) The operating effectiveness of the controls.
  - (h) A statement that the engagement was performed in accordance with ISAE 3402 "Assurance Reports on a Service Organization's Controls".
  - (i) A summary of the service auditor's procedures, and, in the case of a Type A report, a statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and therefore no opinion is expressed thereon.
  - (k) The service auditor's opinion, expressed in the positive form, on whether:
    - (i) Management's description of controls and control objectives presents fairly, in all material respects, the relevant aspects of the service organization's controls that had been implemented:
      - as at a specified date, in the case of a Type A report; or
      - throughout the period, in the case of a Type B report;
    - (ii) The controls are suitably designed to provide reasonable assurance that the specified control objectives will be achieved if the controls operate effectively;
    - (iii) The controls were in existence:
      - as at a specified date, in the case of a Type A report; or
      - throughout the period, in the case of a Type B report; and
    - (iv) In the case of a Type B report, the controls operated effectively to achieve the specified control objectives throughout the specified period.
  - (l) If the service auditor concludes that the description of controls does not fairly state significant changes in the service organization's controls during the period, a description of those changes.
  - (m) The assurance report date.
  - (n) The name of the service auditor, and the city where the service auditor maintains the office that has responsibility for the engagement.
37. In the case of a Type B report, the assurance report shall include a separate section that describes the service auditor's tests of controls and the results thereof. In describing the tests of controls, the auditor shall indicate the nature and timing of the tests in sufficient detail to

enable user auditors to determine the effect of such tests on their risk assessments. If deviations have been identified, the auditor shall include:

- (a) Information about causative factors, to the extent the service auditor has identified such factors;
- (b) The current status of corrective actions, to the extent the service auditor has determined the status; and
- (c) The extent of testing performed by the service auditor that led to identification of the deviations.

#### *Modified Opinions*

38. If the service auditor concludes that:

- (a) Management's description of controls and control objectives is not presented fairly in all material respects;
- (b) The controls are not suitably designed to provide reasonable assurance that the specified control objectives will be achieved if the controls operate effectively;
- (c) The controls were not in existence as at a specified date; or
- (d) In the case of a Type B report, the controls did not operated effectively throughout the specified period

the service auditor's opinion shall be modified, and the assurance report shall contain a clear description of all the reasons.

#### **Other Reporting Responsibilities**

39. If the service auditor becomes aware of illegal acts, fraud or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether this information has been communicated appropriately to affected user entities. If the information has not been so communicated and management of the service organization is unwilling to do so, the service auditor shall take appropriate action.

## Appendix 1

**REFER TO THE ISSUES PAPER FOR THE STATUS OF THIS APPENDIX**

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### **Illustrative Control Objectives for Various Types of Service Organizations**

#### **INFORMATION SYSTEMS**

The following illustrative information technology (IT) control objectives may be applicable to any service organization that uses IT in providing services that are part of a user organization's information system. They should be considered in addition to the illustrative control objectives that are applicable to specific types of service organizations.

Controls provide reasonable assurance that:

- New applications being developed are authorized, tested, approved, properly implemented, and documented.
- Changes to existing applications are authorized, tested, approved, properly implemented, and documented.
- Changes to the existing system software and implementation of new system software are authorized, tested, approved, properly implemented, and documented.
- Physical access to computer equipment, storage media, and program documentation is restricted to properly authorized individuals.
- Logical access to system resources (for example, programs, data, tables, and parameters) is restricted to properly authorized individuals.
- Processing is appropriately authorized and scheduled and that deviations from scheduled processing are identified and resolved.
- Data transmissions between the service organization and its user organizations are complete and accurate.

#### **INVESTMENT ADVISER**

The control objectives included in this section would be appropriate for an investment adviser who performs some or all of the following functions.

- Initiating and executing purchase and sale transactions, either by specific direction from the client or under discretionary authority granted by the client
- Determining whether transactions comply with guidelines and restrictions
- Reconciling records of security transactions and portfolio holdings, for each client, to statements received from the custodian
- Reporting to the customer on portfolio performance and activities

### **Illustrative Control Objectives for an Investment Adviser**

Controls provide reasonable assurance that:

- Investment guidelines and restrictions are established and monitored.
- Securities transactions and portfolio holdings are monitored for compliance with client guidelines and regulatory requirements, and are managed in accordance with investment objectives.
- Portfolio security purchase and sale transactions are appropriately authorized.
- Portfolio security purchase and sale transactions are executed timely and accurately.
- The cost of securities purchased and the proceeds of securities sold are accurately allocated among client accounts in accordance with company policy.
- Client account transactions and cash and security positions are completely and accurately recorded and settled in a timely manner.
- Securities are valued using current prices obtained from sources authorized by the customer.
- Controls provide reasonable assurance that investment income is accurately recorded in the proper period.
- Investment management fees and other account expenses are accurately calculated and recorded.
- Corporate actions are identified, processed, and recorded accurately and timely.

### **SECURITIES CUSTODIAN AND SERVICER**

The control objectives in this section would be appropriate for a securities holder (custodian) and servicer that perform some or all of the following functions:

- Maintaining custody of securities and records of the securities held for the entities (Such securities may exist in physical or electronic form.)
- Collecting dividend and interest income and distributing such income to the entities
- Receiving notification of corporate actions and reflecting such actions in the records of entities
- Receiving notification of security purchase and sale transactions on behalf of entities for which the custodian is holding securities, and reflecting such transactions in the records of the entities
- Receiving payments from purchasers and disbursing proceeds to sellers for security purchase and sale transactions

### **Illustrative Control Objectives for a Securities Custodian and Servicer**

Controls provide reasonable assurance that:

- Changes to nonmonetary participant data (for example, address changes and changes in allocation instructions) are authorized and correctly recorded on a timely basis.

- Trades are authorized, recorded, settled, and reported completely, accurately, and timely and in accordance with the client agreement.
- Investment income is collected and recorded accurately and timely.
- Corporate actions are identified, processed, settled, and recorded accurately and timely.
- The market values of securities are calculated based on market prices obtained from authorized pricing sources.
- Cash receipts and disbursements are authorized, processed, and recorded completely, accurately, and timely.
- Physically-held securities are protected from loss, misappropriation, and unauthorized use.
- The entity's records accurately reflect securities held by third parties, for example, depositories or subcustodians.
- Lender and borrower participation in lending programs is authorized.
- Loan initiation, processing, maintenance, and termination are recorded accurately and timely.
- Loans are adequately collateralized, and collateral is recorded timely and accurately.
- Collateral is invested in accordance with the lender agreement and income is calculated and distributed accurately and timely.

#### **PARTICIPANT RECORDKEEPER FOR DEFINED CONTRIBUTION PLANS**

The illustrative control objectives included in this section would be appropriate for a participant recordkeeper for defined contribution plans that perform some or all of the following functions.

- Maintaining records of participant and employer contributions, disbursements, and account balances based on information received from the plan sponsor, participant, mutual fund investment adviser, transfer agent, custodian and others.
- Receiving instructions from participants and plan sponsors regarding investment elections, distributions, loans, hirings, terminations, and other matters, and communicating these instructions to other service organizations, such as transfer agents and custodians responsible for executing these instructions.
- Performing valuations of participant accounts and transactions.
- Periodic reporting to participants and plan sponsors.

#### **Illustrative Control Objectives for Participant Recordkeepers for Defined Contribution Plans**

Controls provide reasonable assurance that:

- New accounts are properly established in the system in accordance with the plan agreement and individual elections.
- Changes to nonmonetary participant data (for example, address changes and changes in allocation instructions) are authorized and correctly recorded on a timely basis.

- Cash receipt transactions, loans, distributions of plan assets, and transactions reflecting a transfer of participants' funds among investment options are recorded accurately, timely, and in accordance with instructions received from plan sponsors or participants.
- Investment income (loss) is accurately and timely allocated and recorded to individual participant accounts.
- Transactions and participant account balances are valued based on market prices obtained from authorized pricing sources.
- Participant transaction confirmations, and participant account statements, are accurate, distributed timely, and mailed directly to participants without intervention by individuals responsible for processing transactions.

## **PORTFOLIO ACCOUNTANT**

The illustrative control objectives in this section would be appropriate for a portfolio accountant that performs some or all of the following services for entities such as mutual funds.

- Maintaining records of securities, cash, and other portfolio assets based on information received from the plan sponsor, investment adviser, transfer agent, custodian and others.
- Performing valuations of portfolio assets and determining net asset values (aggregate and per unit).
- Periodic reporting to plan sponsors, investment advisers, and others.

### **Illustrative Control Objectives for a Portfolio Accountant**

Controls provide reasonable assurance that:

- Portfolio transactions are authorized, and processed and settled accurately and timely.
- Securities costs are accurately calculated and recorded.
- Portfolio securities are valued using current prices obtained from sources authorized by the customer.
- Investment income is accurately and timely calculated, and recorded.
- Corporate actions are processed completely, accurately, and timely.
- Expenses are accurately calculated, and recorded in accordance with the customer's instructions.
- The entity's capital stock (unit) activity is recorded completely, accurately, and timely.
- Dividend distribution rates are authorized and dividend amounts are timely and accurately calculated and recorded.
- Net asset value is accurately calculated.

## **TRANSFER AGENT**

A transfer agent may perform a transfer function, registrar function, or both. The transfer function includes:

- Canceling old certificates that are properly presented and endorsed in good deliverable form (which usually includes a signature guarantee).
- Making appropriate adjustments to the issuer's shareholder records.
- Establishing a new account and issuing new certificates in the name of the new owner.
- Reviewing legal documents to ensure that they are complete and in perfect order before transferring the securities.
- If the legal documents are incomplete, notifying the presenter that the documents are incomplete and holding the old certificate and accompanying documentation until the presenter sends the transfer agent the proper documents or rejecting the transfer and returning the securities.

The registrar function includes:

- Monitoring the issuance of securities in an issue to prevent the unauthorized issuance of securities.
- Ensuring that the issuance of the securities will not cause the authorized number of shares in an issue to be exceeded and that the number of shares represented by the new certificates corresponds to the number of shares on the canceled ones.
- Countersigning the certificate, after performing the functions listed above.

In addition to the functions of a transfer agent, a transfer agent that processes for mutual funds is also responsible for:

- Recording the amount of securities purchased by a shareholder on the issuer's books and redeeming (liquidating) shares upon receipt of the customer's written or wire request.
- Maintaining records of the name and address of each security holder, the amount of securities owned by each security holder, the certificate numbers corresponding to a security holder's position, the issue date of the security certificate, and the cancellation date of the security certificate.
- For many transfer agents, acting as paying agent for cash dividends and distributions of stock dividends and stock splits.

The following set of control objectives are applicable depending on the functions performed.

### **Illustrative Control Objectives for a Transfer Agent**

Controls provide reasonable assurance that:

- Transactions and adjustments, including as-of transactions, are authorized, processed accurately and timely, and valued at proper dollar and share amounts.
- Dividend and distribution rates are authorized, and dividend and distribution amounts are accurately and timely calculated and recorded.
- Transactions and adjustments are authorized and processed accurately.
- Fund distributions are properly recorded in shareholder accounts and are properly updated to the system.
- Tax withholdings are properly calculated, recorded and remitted.



- Shareholder account maintenance transactions are properly authorized and recorded and accurately and timely recorded.
- The master security file, the detail security holder file, and the authorized share total records are accurately maintained.
- Securities in the custody or possession of the transfer agent are protected from loss, misappropriation, or unauthorized use.
- Transfer-agent records accurately reflect cash held by third parties.
- Checks and certificates issued are authorized and timely and accurately recorded.
- Lost and stolen certificates are recorded timely and accurately.

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This section sets out detailed control objectives for the financial service activities referred to in paragraph 6. These control objectives are for guidance only and are not intended to be exhaustive, and it remains the responsibility of the directors to ensure that the described control objectives are sufficient to meet the expectations of customers.

**(a) CUSTODY**

*Accepting clients*

- > Accounts are set up and administered in accordance with client agreements and applicable regulations
- > Complete and authorized client agreements are operative prior to initiating custody activity
- > Investment holdings transferred from prior custodians are received and recorded completely, accurately and on a timely basis
- > Client take-ons are monitored, documented and accurately reported to clients

*Authorizing and processing transactions*

- > Investment and related cash and foreign exchange transactions are authorized and recorded completely, accurately and on a timely basis
- > Investment and related cash and foreign exchange transactions are settled and failures are resolved in a timely manner
- > Corporate actions and voting instructions are identified, processed and recorded on a timely basis
- > Cash receipts and payments are authorized, processed and recorded completely, accurately and on a timely basis
- > Lender and borrower participation in lending programs is authorized and loan initiation, maintenance and termination are accurate and timely
- > Loans are fully collateralized and the collateral together with its related income is recorded completely, accurately and on a timely basis

*Maintaining financial and other records*

- > Investment income and related tax reclaims are collected and recorded accurately and on a timely basis
- > Investments are valued using current prices obtained from independent external pricing sources and portfolio valuations are complete and distributed on a timely basis
- > Asset positions for securities held by third parties such as sub custodians and depositories are accurately recorded and regularly reconciled

*Safeguarding assets*

- > Physically held securities are safeguarded from loss, misappropriation and unauthorised use

*Monitoring compliance*

- > Sub-custodians are approved and performance standards are monitored on a timely basis
- > Outsourced activities are properly managed and monitored
- > Transaction errors are rectified promptly and clients treated fairly

*Reporting*

- > Client reporting in respect of client asset holdings is complete and accurate and provided within required timescales
- > Asset positions and details of securities lent are reported to interested parties accurately and within the required time scale, including those responsible for initiating voting instructions, accurately and within required timescales

*Information technology*

- > See Appendix 1 (g)

**(b) INVESTMENT MANAGEMENT**

*Accepting clients*

- > Accounts are set up and administered in accordance with client agreements and applicable regulations
- > Complete and authorized client agreements are operative prior to initiating investment activity
- > Client take-ons are monitored, documented and accurately reported to clients
- > Investment guidelines and restrictions are established
- > Responsibility for generating proxy voting instructions is clearly established
- > Pooled fund unitholder activity is recorded completely, accurately and in a timely manner

*Authorizing and processing transactions*

- > Investment strategy is set and implemented in a timely manner
- > Investment transactions are properly authorized, executed and allocated in a timely, cost effective and accurate manner
- > Transactions are undertaken only with approved counterparties
- > Commission levels and transaction costs are monitored
- > Investment and related cash transactions are completely and accurately recorded and settled in a timely manner

- > Corporate actions and proxy voting instructions are identified and generated, respectively, and then processed and recorded accurately and in a timely manner
- > Client new monies and withdrawals are authorized, processed and recorded completely and accurately

*Maintaining financial and other records*

- > Investment income is accurately recorded in the proper period
- > Investments are valued using current prices obtained from independent external pricing sources
- > Cash and securities positions are completely and accurately recorded and reconciled to third party data
- > Investment management fees and other account expenses are accurately calculated and recorded
- > Pooled funds are priced and administered accurately and in a timely manner

*Safeguarding assets*

- > Uninvested cash is managed with due regard to diversification of risk and security of funds
- > Investments are properly registered and client money is segregated

*Monitoring compliance*

- > Client portfolios are managed in accordance with investment objectives, monitored for compliance with investment guidelines and restrictions and performance is measured
- > Outsourced activities are properly managed and monitored
- > Transaction errors (including guideline breaches) are rectified promptly and clients treated fairly
- > The effective transmission of proxy voting instructions is assessed regularly on a sample basis

*Reporting to clients*

- > Client reporting in respect of portfolio transactions, holdings and performance, commission and voting is complete and accurate and provided within required timescales

*Information technology*

- > See Appendix 1 (g)

**(c) PENSION ADMINISTRATION**

*Accepting clients*

- > Accounts are set up and administered in accordance with client agreements and applicable regulations
- > Complete and authorized client agreements are operative prior to initiating administration activity

- > Pension schemes taken on are properly established in the system in accordance with the scheme rules and individual elections

*Authorizing and processing transactions*

- > Contributions to defined contribution plans, defined benefit schemes, or both, and transfers of members' funds between investment options are processed accurately and in a timely manner
- > Benefits payable and transfer values are calculated in accordance with scheme rules and relevant legislation and are paid on a timely basis

*Maintaining financial and other records*

- > Member records consist of up to date and accurate information and are updated and reconciled regularly
- > Contributions and benefit payments are completely and accurately recorded in the proper period
- > Investment transactions, balances and related income are completely and accurately recorded in the proper period
- > Scheme documents (deeds, policies, contracts, booklets etc) are complete, up to date and securely held

*Safeguarding assets*

- > Member and scheme data is appropriately stored to ensure security and protection from unauthorized use
- > Cash is safeguarded and payments are suitably authorized and controlled

*Monitoring compliance*

- > Contributions are received in accordance with scheme rules and relevant legislation
- > Services provided to pension schemes are in line with service level agreements
- > Transaction errors are rectified promptly and clients treated fairly

*Reporting to clients*

- > Periodic reports to participants and scheme sponsors are accurate and complete and provided within required timescales
- > Annual reports and accounts are prepared in accordance with applicable law and regulations
- > Regulatory reports are made if necessary

*Information technology*

- > See Appendix 1 (g)

**(d) PROPERTY MANAGEMENT**

*Accepting clients*

- > Accounts are set up and administered in accordance with client agreements and applicable regulations
- > Complete and authorized client agreements are operative prior to initiating investment activity
- > Client take-ons are monitored, documented and accurately reported to clients
- > Investment guidelines and restrictions are established
- > Pooled fund unitholder activity is recorded completely, accurately and in a timely manner

*Authorizing and processing transactions*

- > Investment decisions are properly formulated in accordance with investment guidelines, authorized, implemented and reviewed on a timely basis
- > Property developments are only undertaken in accordance with acceptable risk criteria
- > Costs associated with buying and selling properties are authorized and recorded accurately
- > Tenants' covenants and lease conditions are assessed and authorized on a timely basis
- > Property and related cash transactions are completely and accurately recorded and settled in a timely manner
- > Rental income and service charges are accurately calculated and recorded on a timely basis
- > Client new monies and withdrawals are authorized, processed and recorded completely and accurately

*Maintaining financial and other records*

- > Complete and accurate records of each property are maintained
- > Valuations are obtained at regular intervals from independent external valuers
- > Income entitlements are received in full, wherever possible, and expenses, both recoverable and irrecoverable, are controlled
- > Property management fees and other account expenses are accurately calculated and recorded
- > Rents are monitored and rent reviews are recorded promptly and accurately
- > Pooled funds are priced and administered accurately and in a timely manner

*Safeguarding assets*

- > Properties purchased are of good and marketable title
- > Title deeds are safeguarded from loss, misappropriation and unauthorized use
- > Uninvested cash is managed with due regard to diversification of risk and security of funds

- > Risks arising from investing in property are insured where this is economic to the interests of owners (for example consider claims etc arising from the public where large shopping malls are owned)

*Monitoring compliance*

- > Client portfolios are managed in accordance with investment objectives, monitored for compliance with investment guidelines and restrictions and performance is measured
- > Outsourced activities are properly managed and monitored
- > Transaction errors (including guideline breaches) are rectified promptly and clients treated fairly

*Reporting to clients*

- > Client reporting in respect of property transactions, holdings and performance is complete and accurate and provided within required timescales

*Information technology*

- > See Appendix 1 (g)

**(e) FUND ACCOUNTING***Accepting clients*

- > Accounts are set up and administered in accordance with client agreements and applicable regulations
- > Complete and authorized client agreements are operative prior to initiating accounting activity
- > Client take-ons are monitored, documented and accurately reported to clients

*Authorizing and processing transactions*

- > Portfolio transactions are recorded completely, accurately and on a timely basis
- > Corporate actions are processed and recorded accurately and on a timely basis
- > Expenses are accurately calculated and recorded in accordance with the requirements of the fund and on a timely basis
- > Distribution rates are accurately calculated and authorized and distribution amounts are recorded in a timely manner

*Maintaining financial and other records*

- > Investment income and related tax are accurately calculated and recorded on a timely basis
- > Investments are valued using current prices obtained from independent external pricing sources
- > Share/unit activity is recorded completely, accurately and positions are regularly reconciled
- > Fund pricing is accurate and timely and box positions are reported accurately and monitored

- > Cash and securities positions are completely and accurately recorded and reconciled to third party data

*Monitoring compliance*

- > Services provided to clients are in line with service level agreements

*Reporting to clients*

- > Net asset value is accurately calculated and reported in a timely manner
- > Periodic reports to unitholders and fund sponsors are accurate and complete and distributed on a timely basis
- > Annual reports and accounts are prepared in accordance with applicable law and regulations

*Information technology*

- > See Appendix 1 (g)

**(f) TRANSFER AGENCY**

*Accepting clients*

- > Accounts are set up and administered in accordance with client agreements and applicable regulations
- > Adherence to subscription limits is checked and recording of client information required by legislation is accurate
- > Complete and authorized client agreements are operative prior to initiating accounting activity
- > Client take-ons are monitored, documented and accurately reported to clients

*Authorizing and processing transactions*

- > Documents received are checked, sorted and distributed for processing in a timely manner
- > Investor transactions and adjustments are authorized, processed accurately, completely and in a timely manner
- > Cash receipts are processed accurately and banked promptly
- > Checks and certificates issued are accurately generated, matched and authorized prior to dispatch
- > Fund distributions and related tax withholdings are accurately calculated and authorized and distributed in a timely manner

*Maintaining financial and other records*

- > Transfer agent records accurately reflect securities and cash held by third parties
- > Share/unit activity is recorded completely, accurately and positions are regularly reconciled



*Safeguarding assets*

- > Lost and stolen certificates are recorded in a timely manner

*Monitoring compliance*

- > Transaction errors are rectified promptly and clients treated fairly

*Reporting to clients*

- > Compensation payments are authorized, calculated and reviewed by management
- > Client reporting is complete and accurate and processed within required timescales

*Information technology*

- > See Appendix 1 (g)

**(g) INFORMATION TECHNOLOGY**

*Restricting access to systems and data*

- > Physical access to computer networks, equipment, storage media and program documentation is restricted to authorized individuals
- > Logical access to computer systems, programs, master data, transaction data and parameters, including access by administrators to applications, databases, systems and networks, is restricted to authorized individuals via information security tools and techniques
- > Segregation of incompatible duties is defined, implemented and enforced by logical security controls in accordance with job roles

*Providing integrity and resilience to the information processing environment, commensurate with the value of the information held, information processing performed and external threats*

- > IT processing is authorized and scheduled appropriately and exceptions are identified and resolved in a timely manner
- > Data transmissions between the service organization and its counterparties are complete, accurate, timely and secure
- > Appropriate measures are implemented to counter the threat from malicious electronic attack (e.g. firewalls, anti-virus etc.)
- > The physical IT equipment is maintained in a controlled environment

*Maintaining and developing systems hardware and software*

- > Development and implementation of new systems, applications and software, and changes to existing systems, applications and software, are authorized, tested, approved and implemented
- > Data migration or modification is authorized, tested and, once performed, reconciled back to the source data

*Recovering from processing interruptions*

- > Data and systems are backed up regularly, retained offsite and regularly tested for recoverability
- > IT hardware and software issues are monitored and resolved in a timely manner
- > Business and information systems recovery plans are documented, approved, tested and maintained

*Monitoring compliance*

- > Outsourced activities are properly managed and monitored