

**Service organizations – ISAE 3402
Significant issues****A. Professional Accountants**

- A.1 At the September meeting, the IAASB observed that the draft ISAE 3402 uses the term “service auditor,” whereas ISAE 3000 uses the term “practitioner.” A practitioner in this context is a professional accountant, but may not be a specialist auditor. The task force was asked to consider whether any limitation should be imposed regarding who can use the ISAE, or alternatively whether the service auditor’s report should include disclosure of information to assist the user auditor in evaluating the skills, knowledge and practical experience of the service auditor.
- A.2 The task force does not consider it necessary to limit those who may use the ISAE, and notes that no such limitation is placed on ISAE 3000. Nor does the task force consider it practicable to require disclosure in the service auditor’s report of the skills, knowledge and practical experience of the service auditor, particularly considering that such reports are often signed in the name of a firm rather than an individual partner, and that it is the combined capabilities of the engagement team rather than of any one individual alone that needs to be considered. The task force has, however, drafted the following paragraphs for insertion in the ISAE should the IAASB choose to limit those who may use the ISAE to:

(a) Professional accountants (or professional accountants in public practice):

This ISAE is for application by professional accountants (in public practice). A professional accountant is “an individual who is a member of an IFAC member body.”¹ IFAC member bodies have obligations with respect to such matters as: quality assurance; education; ethics; and investigation and discipline.² These obligations form the basis of the IFAC Member Body Compliance Program, and underlie the confidence placed in assurance reports issued under this ISAE.

(b) Professional accountants who are specialist auditors:

IES 8 prescribes competence requirements for professional accountants who have responsibility, or have been delegated responsibility, for significant judgments in an audit of historical financial information.³ While an engagement to report on a service organization’s controls is not an audit of historical financial information, the requirements of IES 8 are still relevant to service auditors because of the nature of the subject matter, and of the professional judgment that the service auditor needs to apply.

B. Link with the ISAs

- B.1 At the September meeting, the IAASB agreed in principle that if a service auditor is to obtain the same level of assurance as an auditor in a financial statements audit, then the requirements in the ISAE should cover similar matters and at a similar level of detail to the ISAs.

¹ The IFAC Code of Ethics for Professional Accountants.

² IFAC Statements of Membership Obligations.

³ International Education Standard 8, “Competence Requirements for Audit Professionals.”

Alternative ways to achieve this are to replicate or adapt relevant requirements included in the ISAs, or to require that the ISAs be applied, adapted as necessary in the circumstances of the engagement.

- B.2 The task force does not think it is appropriate to require the ISAs to be applied, adapted as necessary in the circumstances of the engagement, because to do so would not result in sufficient clarity as to which requirements of the ISAs should be applied or how they ought to be adapted. The task force has added a number of requirements based on the ISAs dealing with internal audit, experts, and sampling, and, having done so, is satisfied that the coverage of topics addressed in the ISAs is at the appropriate level of detail in the current draft ISAE.

C. Criteria

- C.1 Example service organization assertions are included in Appendix 1 to the draft ISAE. These assertions include criteria for each of the three opinions (fairness of the description, suitability of design, and operating effectiveness of controls), and are consistent with the requirements of paragraphs 14-16.
- C.2 At the September meeting, the task force was asked to consider whether qualitative characteristics such as completeness and understandability should be incorporated into the criteria for the fair presentation of the description of the system because consideration of such characteristics form part of the service auditor's judgment. The task force considers that specific reference to such characteristics is not required as they are inherently part of considering whether the description "omits or distorts" relevant information (paragraph 14 (b))
- C.3 The task force was also asked to consider whether the criteria for the suitability of design and the operating effectiveness of controls, which were expressed at the opinion level, should be further broken down to reflect in more detail the matters the service auditor considers when forming conclusions. The task force has done this in paragraphs 15 and 16.

D. Materiality

- D.1 In discussing the concept of materiality in an ISAE 3402 engagement, the task force considered whether users are likely to have a common understanding of the circumstances that would cause the service auditor to express a modified opinion. The task force considered whether greater consistency of approach to determining and/or disclosing materiality considerations was needed, in particular with respect to the rate of deviation that the service auditor would consider tolerable because this is a primary determinant of whether a modified opinion would be expressed about the operating effectiveness of controls. A number of options were considered, including:
- Requiring that a particular tolerable rate of deviation be used in the absence of unusual circumstances.
 - Requiring that the tolerable rate of deviation used in determining sample sizes be disclosed.
 - Requiring that sample sizes used be disclosed.

- D.2 The task force concluded that it is appropriate for the auditor to be required to disclose the sample size used when a deviation is found (paragraph 56 (b)) because it provides relevant information to user auditors in making their risk assessments. However, the task force concluded that it would not be appropriate to require disclosure of sample sizes or tolerable rates in other circumstances because readers would not have enough information to fully understand the judgments made by the service auditor in their determination, and may therefore be susceptible to misinterpretation and result in either under- or over-reliance on the work of the service auditor.
- D3. In an effort to bring greater consistency to the determination of sample sizes, however, the task force decided to include in the application material an indication of the sample size ordinarily used by many service auditors and the basis of its calculation (paragraph A25)

E. Control Objectives

- E.1 At the September meeting, the task force was asked to consider whether the example control objectives included in an appendix to the draft presented at that meeting should be more closely aligned with ISA 315, and whether the number of examples should be reduced. In considering these matters, the task force also considered whether the IT objectives in the previous draft were appropriate to include at all. Although nearly all outsourcing involves IT in one way or another, the nature of specific objectives in relation to IT can vary considerably from one application to the next. Similarly, the nature of transaction-based objectives can vary considerably and, while they could be written in a generalized manner, it was thought that including high-level generic transaction-based objectives was unlikely to be fruitful. The appendix has, therefore, been deleted.

F. Intended Users and Purpose

- F.1 At the September meeting, the IAASB agreed that the application material regarding the service auditor's report should include an explanation of the rationale as to why use of the report is restricted to those who have a practical understanding of the service organization's system. In discussing this issue, the task force decided that rather than seeking to impose restrictions on distribution of the report (paragraph 55 (f)), the example report wording (Appendix 2), as well as the application material (paragraph A30), should be clearer in identifying the specific purpose and specific users for which the report has been prepared. The wording included in the example report is:

This report and the description of tests of controls on pages [yy-zz] are intended only for existing customers of XYZ Service Organization's [type or name of] system and their auditors who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers' financial statements.

G. Availability of Assertions

- G.1 As agreed at previous meetings, the draft has been written for application to assertion-based engagements, albeit that assertion-based engagements are not current practice in some jurisdictions. The explanatory memorandum will seek specific comment on this change, and will specifically ask if there are situations in which it would not be possible to obtain the required assertions (for example, situations in which a service auditor's assurance report may be required pursuant to specific contractual, statutory or regulatory requirements). The task force is preparing a list of significant service organizations and representative bodies in various jurisdictions from whom comment on the issue of assertion-based engagements will actively be sought. IAASB members and Technical Advisers are asked to provide the task force chair and staff with the details of any service organizations from which they would like comment to be sought.