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Changes made to the December 2007 exposure draft (ED) of International Standard on Auditing (ISA) 402 (revised and redrafted), audit considerations relating to an entity using a third party service organization, and proposed statement on auditing standards (SAS) audit considerations relating to an entity using a service organization; Exposure draft (American Institute of Certified Public Accountants), 2008, November 17

American Institute of Certified Public Accountants. Auditing Standards Board

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Changes Made to the December 2007 Exposure Draft (ED) of International Standard on Auditing (ISA) 402 (Revised and Redrafted), *Audit Considerations Relating to an Entity Using a Third Party Service Organization*, and Proposed Statement on Auditing Standards (SAS) *Audit Considerations Relating to an Entity Using a Service Organization*¹

December 2007 ED of ISA 402, <i>Audit Considerations Relating to an Entity Using a Third Party Service Organization</i>	Proposed ISA 402 <u>SAS</u> <i>Audit Considerations Relating to an Entity Using a Third-Party Service Organization</i>	Relevant Paragraphs in Extant AU Section 324, <i>Service Organizations</i> (AICPA, <i>Professional Standards</i> , vol. 1)	Explanation of Substantive Changes to the ISA 402 ED and Other Comments
<p>Introduction</p> <p>Scope of this ISA</p> <p>1. This International Standard on Auditing (ISA) deals with the user auditor’s responsibilities to obtain sufficient appropriate audit evidence when an entity uses one or more third party service organizations. Specifically, it expands on how the auditor applies ISA 315 (Redrafted)¹ and ISA 330 (Redrafted)² in identifying and assessing the risks of material misstatement and in designing and performing further audit procedures.</p> <p>¹ ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment.”</p> <p>² ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks.”</p>	<p>Introduction</p> <p>Scope of This ISA <u>Statement on Auditing Standards</u> (SAS)</p> <p>1. This International Standard on Auditing (ISA) <u>Statement on Auditing Standards (SAS)</u> addresses the user auditor’s responsibilities for <u>to</u> obtaining sufficient appropriate audit evidence when <u>in an audit of the financial statements of an entity that</u> uses one or more third party <u>service</u> organizations. Specifically, it expands on how the auditor applies ISA 315 (Redrafted)⁴ and ISA 330 (Redrafted)² <u>AU section 314, <i>Understanding The Entity and Its Environment and Assessing the Risks of Material Misstatement</i>, and AU section 318, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i> (AICPA, <i>Professional Standards</i>, vol. 1),</u> in identifying and assessing the risks of material misstatement and in designing and performing further audit procedures.</p> <p>⁴ ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment.”</p> <p>² ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks.”</p>	<p>.01 This section provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity that uses a service organization to process certain transactions. This section also provides guidance for independent auditors who issue reports on the processing of transactions by a service organization for use by other auditors.</p> <p>.07 Section 314, <i>Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement</i>, states that an auditor should obtain an understanding of each of the five components of the entity’s internal control sufficient to assess the risk of material misstatement. This understanding may encompass controls placed in operation by the entity and by service organizations whose services are part of the entity’s information system. In planning the audit, such knowledge should be used to—</p> <ul style="list-style-type: none"> • Identify types of potential misstatements. • Consider factors that affect the risk of material misstatement. • Design tests of controls, when applicable. <p>Paragraphs .23 through .27 of section 318 discuss factors the auditor considers in determining whether to perform tests of controls</p> <ul style="list-style-type: none"> • Design substantive tests. 	
<p>2. Many entities outsource aspects of their business to organizations that provide services ranging from performing a specific task under the direction of an entity to</p>	<p>2. Many entities outsource aspects of their business <u>activities</u> to organizations that provide services ranging from performing a specific task under the direction of an <u>the</u> entity to replacing an</p>		

¹ New material added to the proposed Statement on Auditing Standards is shown underlined and deletions are marked with strikethrough.

December 2007 ED of ISA 402, <i>Audit Considerations Relating to an Entity Using a Third Party Service Organization</i>	Proposed ISA 402 SAS <i>Audit Considerations Relating to an Entity Using a Third Party Service Organization</i>	Relevant Paragraphs in Extant AU Section 324, <i>Service Organizations (AICPA, Professional Standards, vol. 1)</i>	Explanation of Substantive Changes to the ISA 402 ED and Other Comments
<p>replacing an entity's entire business units or functions. Many of the services provided by such organizations are integral to the entity's business operations; however, not all those services are directly linked to an entity's information system relevant to financial reporting.</p>	<p>entity's entire business units or functions of the entity. Many of the services provided by such organizations are integral to the entity's business operations; however, not all of those services are <u>necessarily</u> directly linked to an entity's information and communication systems relevant to financial reporting.¹</p> <p>¹ Paragraph .41 of AU section 314, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AICPA, Professional Standards, vol. 1)</i>, indicates that an entity's information and communication systems is a component of its internal control over financial reporting. The other components are the control environment, the entity's risk assessment, control activities, and monitoring.</p>		<p>Paragraph .83 of AU section 314, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AICPA, Professional Standards, vol. 1)</i>, uses the term <i>information and communication systems</i>.</p>
<p>3. A service organization's services are part of an entity's information system, including related business processes, relevant to financial reporting if they affect any of the following:</p> <p>(a) The classes of transactions in the entity's operations that are significant to the entity's financial statements;</p> <p>(b) The procedures, within both information technology (IT) and manual systems, by which the entity's transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;</p> <p>(c) The related accounting records, either in electronic or manual form, supporting information and specific accounts in the</p>	<p>3. A service organization's services are part of an entity's information system and communication <u>systems</u>, including related business processes, relevant to financial reporting if they affect any of the following:</p> <p>(a) The classes of transactions in the entity's operations that are significant to the entity's financial statements;</p> <p>(b) The procedures, within both information technology (IT) automated and manual systems, by which the entity's transactions are initiated, <u>authorized</u>, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;</p> <p>(c) The related accounting records, either in (whether electronic or manual form); supporting information; and specific accounts in the entity's</p>	<p>.03 The guidance in this section is applicable to the audit of the financial statements of an entity that obtains services from another organization that are part of its information system. A service organization's services are part of an entity's information system if they affect any of the following:</p> <ul style="list-style-type: none"> • The classes of transactions in the entity's operations that are significant to the entity's financial statements • The procedures, both automated and manual, by which the entity's transactions are initiated, authorize, recorded, processed, and reported from their occurrence to their inclusion in the financial statements • The related accounting records, whether electronic or manual, supporting information, and specific accounts in the entity's financial statements involved 	<p>Changes were made to paragraph 3 of the ISA ED to conform to the language in paragraph .83 of AU section 314.</p>

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<p>entity's financial statements that are used to initiate, record, process and report the entity's transactions; this includes the correction of incorrect information and how information is transferred to the general ledger;</p> <p>(d) How the entity's information system captures events and conditions, other than transactions, that are significant to the financial statements;</p> <p>(e) The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures; and</p> <p>(f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.</p>	<p>financial statements that are used to initiate, record, process, and report the entity's transactions; This includes the correction of incorrect information and how information is transferred to the general ledger;</p> <p>(d) How the entity's information system captures and communication systems capture events and conditions, other than transactions, that are significant to the financial statements;</p> <p>(e) The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures; and</p> <p>(f) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.</p>	<p>in initiating, recording, processing and reporting the entity's transactions</p> <ul style="list-style-type: none"> • How the entity's information system captures other events and conditions that are significant to the financial statements • The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures ... 	
<p>4. The focus of this ISA is on an entity's use of a third party service organization, but it may also be applicable, adapted as necessary in the circumstances, to situations where an entity uses a shared service center which provides services to a group of related entities.</p>	<p>4. The focus of this ISASAS is on an entity's use of a third partyoutside service organization, but it may also be applicable, adapted as necessary in the circumstances, to situations where an entity uses a shared service center which organization that provides services to a group of related entities.</p>		<p>The term <i>third party</i> was deleted from the ISA ED because it is not a defined term in the SASs</p>
<p>5. This ISA does not apply to services provided by an organization, such as a financial institution, that are limited to processing an entity's transactions that are specifically authorized by the entity, such as the processing of checking account transactions by a bank or the processing of securities transactions by a broker. In addition, this ISA does not apply to the audit of transactions arising from</p>	<p>5. This ISASAS does not apply to services provided by an organization, such as a financial institution, that are limited to processing an entity's transactions that are specifically authorized by the entity, such as the processing of checking account transactions by a bank or the processing of securities transactions by a broker. <u>In these situations, the user entity retains responsibility for authorizing the transactions and maintaining the related accountability.</u> In addition, this ISASAS</p>		<p>Paragraph 5 of the ISA ED was revised to clarify why it is not applicable to certain service organization and user entity</p>

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proprietary financial interests in other entities, such as partnerships, corporations and joint ventures, when proprietary interests are accounted for and reported to interest holders.	does not apply to the audit of transactions arising from proprietary financial interests in other entities, such as partnerships, corporations, and joint ventures, when proprietary interests are accounted for and reported to interest holders.		relationships.
Effective Date 6. This ISA is effective for audits of financial statements for periods beginning on or after [December 15, 2009].	Effective Date 6. This ISA <u>SAS</u> is effective for audits of financial statements for periods beginning on or after [December 15, 2010]. <u>*Earlier application is permitted.</u> <u>* This effective date is provisional, but will not be earlier than December 15, 2010.</u>	.63 This section is effective for service auditors' reports dated after March 31, 1993. Earlier application of this section is encouraged.	
Objective 7. The objective of the auditor, when the user entity uses a service organization, is to obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit sufficient to identify, assess and respond to the risks of material misstatement.	Objective 7. The objective of the auditor, when the user entity uses a service organization, is to obtain an understanding of the nature and significance of the services provided by the service organization and their effect on the user entity's internal control relevant to the audit sufficient to identify, assess, and respond to the risks of material misstatement.		
Definitions 8. For purposes of this ISA, the following terms have the meanings attributed below: (a) Complementary user entity controls – Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are	Definitions 8. For purposes of this ISA <u>SAS</u> , the following terms have the meanings attributed below <u>as follows</u> : (a) Complementary user entity controls— <u>(a) Complementary user entity controls—</u> Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve <u>the control objectives stated in the c</u> , are	.02 For purposes of this section, the following definitions apply: .31 and .46 It may become evident to the service auditor, when considering the service organization's description of controls placed in operation, that the system was designed with the assumption that certain controls would be implemented by the user	

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<p>identified in the description of the system.</p> <p>(b) Service auditor – An auditor who provides an assurance report on the controls of a service organization.</p> <p>(c) Service organization – A third party organization (or segment of a third party organization) that provides services to user entities that are part of those entities' information system relevant to financial reporting.</p> <p>(d) Subservice organization – A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information system relevant to financial reporting.</p> <p>(e) User auditor – An auditor who audits and reports on the financial statements of a user entity.</p> <p>(f) User entity – An entity that uses a service organization and whose financial statements are being audited.</p> <p>(g) Report on the description and design of controls at a service organization (referred to in this ISA as a Type A report) – A report that comprises:</p> <p>(i) A description, prepared by management of the service organization, of the system, control objectives and related controls that have been designed and implemented as at a specified date; and</p>	<p>identified <u>as such in that description.</u></p> <p>(b) Service auditor. An <u>auditor practitioner</u> who <u>provides an assurance reports</u> on the controls of <u>at</u> a service organization.</p> <p>(c) Service organization. <u>An third party organization or segment of an third party organization</u> that provides services to user entities that are part of those <u>user entities' information and communication systems</u> relevant to financial reporting.</p> <p>(d) Subservice organization— A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' <u>information and communication systems</u> relevant to financial reporting.</p> <p>(e) User auditor— An auditor who audits and reports on the financial statements of a user entity.</p> <p>(f) User entity— An entity that uses a service organization and whose financial statements are being audited.</p> <p>(g) Report on <u>the a description and design of controls at a service organization's system and the suitability of the design of controls—</u> (referred to in this ISA SAS as a <u>type A1 report</u>), (Ref: par. A1) A report that comprises</p> <p><u>a. Aa description of the service organization's system-prepared by management of the service organization, control objectives and related controls that have been designed and implemented as at a specified date; and</u></p>	<p>organization ...</p> <ul style="list-style-type: none"> • Service auditor—The auditor who reports on controls of a service organization that may be relevant to a user organization's internal control as it relates to an audit of financial statements • Service organization—The entity (or segment of an entity) that provides services to a user organization that are part of the user organization's information system <p>Interpretation No. 2 of AU section 324</p> <p>.04 A service organization may use the services of another service organization, such as a bank trust department that uses an independent computer processing service organization to perform its data processing. In this situation, the bank trust department is a service organization and the computer processing service organization is considered a subservice organization.</p> <p>.02</p> <ul style="list-style-type: none"> • User auditor—The auditor who reports on the financial statements of the user organization <p>User organization—The entity that has engaged a service organization and whose financial statements are being audited</p> <ul style="list-style-type: none"> • Report on controls placed in operation—A service auditor's report on a service organization's description of its controls that may be relevant to a user organization's internal control as it relates to an audit of financial statements, on whether such controls were suitably designed to achieve specified control objectives, and on whether they had been placed in operation as of a specific date (Paragraph 24a contains similar information.) 	<p>The definition of the term <i>service auditor</i> was revised to conform to the definition of that term in the related proposed SSAE, <i>Reporting on Controls at a Service Organization</i>.</p> <p>The terms <i>Type A</i> and <i>Type B report</i> were globally replaced with the terms <i>type 1</i> and <i>type 2 report</i> because existing global practice is to use the terms <i>type 1</i> and <i>type 2 report</i>.</p> <p>Paragraphs 8(g) and 8(h) of the ISA ED (the definitions of type A and type B reports) were revised to (1) better reflect the content of the service auditor's report and (2) conform those definitions to the definitions in the proposed SSAE.</p> <p>Throughout the document, the term <i>description of the service organization's</i></p>

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<p>(ii) A report conveying reasonable assurance that includes the service auditor's opinion on the description of the system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.</p> <p>(h) Report on the description, design, and operating effectiveness of controls at a service organization (referred to in this ISA as a Type B report) – A report that comprises:</p> <p>(i) A description, prepared by management of the service organization, of the system, control objectives and related controls, their design and implementation, and their operating effectiveness throughout a specified period; and</p>	<p><u>b. a written assertion by the service organization's management about whether, in all material respects, and based on suitable criteria</u></p> <p><u>(1) the description of the service organization's system fairly presents the service organization's system that was designed and implemented as of a specified date.</u></p> <p><u>(2) the controls related to the control objectives stated in the description were suitably designed to achieve those control objectives as of the specified date.</u></p> <p><u>c.(ii) A a service auditor's report conveying reasonable assurance that includes:</u></p> <p><u>(1) expresses an The service auditor's opinion about the matters in b(1)–b(2) on the description of the system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and</u></p> <p><u>(h) Report on the a description, design, and operating effectiveness of controls at a service organization's system and the suitability of the design and operating effectiveness of controls</u> – (referred to in this ISA SAS as a <u>Type B2 report</u>). (Ref: par. A1) A report that comprises</p> <p><u>(i) a. Aa description prepared by management of the service organization of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date; and prepared by management of the service organization.</u></p>	<p>• Report on controls placed in operation and tests of operating effectiveness—A service auditor's report on a service organization's description of its controls that may be relevant to a user organization's internal control as it relates to an audit of financial statements,¹ on whether such controls were suitably designed to achieve specified control objectives, on whether they had been placed in operation as of a specific date, and on whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the related control objectives were achieved during the period specified. (Paragraph 24a contains similar information.)</p>	<p>system has been used in place of <i>description of the system</i> to clarify which description is being referred to.</p>

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<p>(ii) A report conveying reasonable assurance that includes:</p> <p>a. The service auditor's opinion on the description of the system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and</p> <p>b. A description of the service auditor's tests of the controls and the results thereof.</p>	<p><u>b. a written assertion by the service organization's management about whether, in all material respects, and based on suitable criteria</u></p> <p><u>(1) the description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period.</u></p> <p><u>(2) the controls related to the control objectives stated in the description of the service organization's system were suitably designed throughout the specified period to achieve those control objectives.</u></p> <p><u>(3) the controls related to the control objectives stated in the description of the service organization's system operated effectively throughout the specified period to achieve those control objectives.</u></p> <p><u>c. (ii) a service auditor's report conveying reasonable assurance that includes:</u></p> <p><u>(1) expresses an opinion about the matters in b(1)–b(3). on the description of the system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and</u></p> <p><u>(2) includes a description of the service auditor's tests of the controls and the results thereof.</u></p>	<p>¹ In this section, a service organization's controls that may be relevant to a user organization's internal control as it relates to an audit of financial statements will be referred to as a service organization's <i>controls</i></p>	
<p>Requirements Obtaining an Understanding of the Services Provided by a Service Organization</p>	<p>Requirements Obtaining an Understanding of the Services Provided by a Service Organization</p>		

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<p>9. When obtaining an understanding of the entity in accordance with ISA 315 (Redrafted),³ the user auditor shall obtain an understanding of how a user entity uses a service organization in its operations, including:</p> <p>(a) The nature of the services provided by the service organization and the significance of those services to the user entity, including the user entity's internal control; (Ref: Para. A1-A2)</p> <p>(b) The nature and materiality of the transactions processed or accounts affected by the service organization and the degree of interaction between the activities of the service organization and those of the user entity; and (Ref: Para. A3-A4)</p> <p>(c) The nature of the relationship between the user entity and the service organization, including the contractual terms for the relevant activities undertaken by the service organization. (Ref: Para. A5-A8)</p> <p>3 ISA 315 (Redrafted), paragraph 11.</p>	<p>9. When obtaining an understanding of the entity in accordance with ISA 315 (Redrafted),³ paragraphs .21 and .40 of AU section 314, the user auditor shouldshall obtain an understanding of how at<u>the</u> user entity uses a service organization in its operations, including:</p> <p>{a} the nature of the services provided by the service organization and the significance of those services to the user entity, including the user entity's internal control; (Ref: para. A1-A2-A3)</p> <p>{b} the nature and materiality of the transactions processed or accounts affected by the service organization and the degree of interaction between the activities of the service organization and those of the user entity; and (Ref: para. A3-A4-A5)</p> <p>{c} the nature of the relationship between the user entity and the service organization, including the contractual terms for the relevant activities undertaken by the service organization. (Ref: para. A56-A89)</p> <p>3 ISA 315 (Redrafted), paragraph 11.</p>		
<p>10. When obtaining an understanding of internal control relevant to the audit in accordance with ISA 315 (Redrafted),⁴ the user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services performed by the service organization, including those that are applied to the transactions processed by the service organization, and relevant monitoring controls. (Ref: Para. A9-A11)</p> <p>⁴ ISA 315 (Redrafted), paragraph 12.</p>	<p>10. When obtaining an understanding of internal control relevant to the audit in accordance with ISA 315 (Redrafted),⁴ paragraphs .40 and .47 of AU section 314, the user auditor shouldshall evaluate the design and implementation of relevant controls at the user entity that relate to the services performed by the service organization, including those <u>controls</u> that are applied to the transactions processed by the service organization, and relevant monitoring controls. (Ref: para. A9-A10-A12)</p> <p>⁴ ISA 315 (Redrafted), paragraph 12.</p>	<p>.07 Section 314, <i>Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement</i>, states that an auditor should obtain an understanding of each of the five components of the entity's internal control sufficient to assess the risk of material misstatement. This understanding may encompass controls placed in operation by the entity and by service organizations whose services are part of the entity's information system. In planning the audit, such knowledge should be used to—</p> <ul style="list-style-type: none"> • Identify types of potential misstatements. • Consider factors that affect the risk of material 	

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		<p>misstatement.</p> <ul style="list-style-type: none"> • Design tests of controls, when applicable. <p>Paragraphs .23 through .27 of section 318 discuss factors the auditor considers in determining whether to perform tests of controls</p> <ul style="list-style-type: none"> • Design substantive tests 	
<p>11. The user auditor shall determine whether a sufficient understanding of the user entity’s internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement. If the user auditor is unable to obtain that understanding from information on the service organization available at the user entity, the user auditor shall obtain audit evidence from one or more of the following procedures: (Ref: Para. A12-A16)</p> <p>(a) Obtaining a Type A or Type B report;</p> <p>(b) Contacting the service organization, through the user entity, to obtain specific information;</p> <p>(c) Requesting that a service auditor be engaged to perform procedures that will provide the necessary information; or</p> <p>(d) Visiting the service organization and performing such procedures.</p>	<p>11. The user auditor shall should determine whether <u>he or she has obtained</u> a sufficient understanding of the user entity’s internal control relevant to the audit has been obtained to provide a basis for the identification and assessment of risks of material misstatement. If the user auditor is unable to obtain that understanding from information on <u>about</u> the service organization available at the user entity, the user auditor shall should obtain audit evidence from one or more of the following procedures: (Ref: para. A12<u>3</u>–A16<u>7</u>)</p> <p>(a)₂ Obtaining a type A<u>1</u> or type B<u>2</u> report;</p> <p>(b)₂ Contacting the service organization, through the user entity, to obtain specific information;</p> <p>(c)₂ Requesting that a service auditor be engaged to perform procedures that will provide the necessary information; or</p> <p>(d)₂ Visiting the service organization and performing such procedures-</p>	<p>.10 After considering the available information, the user auditor may conclude that he or she has the means to obtain a sufficient understanding of internal control to plan the audit. If the user auditor concludes that information is not available to obtain a sufficient understanding to plan the audit, he or she may consider contacting the service organization, through the user organization, to obtain specific information or request that a service auditor be engaged to perform procedures that will supply the necessary information, or the user auditor may visit the service organization and perform such procedures. If the user auditor is unable to obtain sufficient evidence to achieve his or her audit objectives, the user auditor should qualify his or her opinion or disclaim an opinion on the financial statements because of a scope limitation</p> <p>.19 ... If the user auditor believes that the service auditor's report may not be sufficient to meet his or her objectives, the user auditor may supplement his or her understanding of the service auditor's procedures and conclusions by discussing with the service auditor the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, he or she may contact the service organization, through the user organization, to request that the service auditor perform agreed-upon procedures at the service organization, or the user auditor may perform such procedures.</p>	
Assessing the Risks of Material Misstatement			

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<p>12. When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively for certain assertions for which controls are applied only at the service organization, the user auditor shall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures: (Ref: Para. A17)</p> <p>(a) Obtaining a Type B report;</p> <p>(b) Requesting the service auditor to perform tests of controls at the service organization on behalf of the user auditor; or</p> <p>(c) Performing appropriate tests of controls at the service organization.</p>	<p>12. When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively for certain assertions for which controls are applied only at the service organization, the user auditor shouldshall obtain audit evidence about the operating effectiveness of those controls from one or more of the following procedures: (Ref: para. A178)</p> <p>(a) Obtaining a type B2 report;</p> <p>(b) Requesting <u>through the user entity that</u> the service auditor to perform tests of controls at the service organization on behalf of the user auditor; or</p> <p>(c) Performing appropriate tests of controls at the service organization.</p> <p><u>d. Performing tests of the user entity's controls over the activities of the service organization</u></p>	<p>.12 A service auditor's report on controls placed in operation at the service organization should be helpful in providing a sufficient understanding to plan the audit of the user organization. Such a report, however, is not intended to provide any evidence of the operating effectiveness of the relevant controls that would allow the user auditor to reduce the assessed level of control risk below the maximum. Such audit evidence should be derived from one or more of the following:</p> <p>a. Tests of the user organization's controls over the activities of the service organization (for example, the user auditor may test the user organization's independent reperformance of selected items processed by a service organization or test the user organization's reconciliation of output reports with source documents)</p> <p>b. A service auditor's report on controls placed in operation and tests of operating effectiveness, or a report on the application of agreed-upon procedures that describes relevant tests of controls</p> <p>c. Appropriate tests of controls performed by the user auditor at the service organization</p> <p>.14 The user auditor may find that controls relevant to assessing control risk below the maximum for particular assertions are applied only at the service organization. If the user auditor plans to assess control risk below the maximum for those assertions, he or she should evaluate the operating effectiveness of those controls by obtaining a service auditor's report that describes the results of the service auditor's tests of those controls (that is, a report on controls placed in operation and tests of operating effectiveness, or an agreed-upon procedures report)² or by performing tests of controls at the service organization. ...</p> <p>² See AT section 201, <i>Agreed-Upon Procedures Engagements</i>, for guidance on performing and reporting</p>	<p>Item <i>d</i> was added to paragraph 12 of the proposed SAS to retain one of the options, in paragraph .12 of extant AU section 324, <i>Service Organizations (AICPA, Professional Standards, vol. 1)</i>, for obtaining evidence about the operating effectiveness of controls.</p>

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		on agreed-upon procedures engagements	
<p>Using an Assurance Report from a Service Auditor</p> <p>13. If the user auditor plans to use a Type A or Type B report as audit evidence about the design and implementation of controls at the service organization, the user auditor shall:(Ref: Para. A18-A19)</p> <p>(a) Evaluate whether the description of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes;</p> <p>(b) Evaluate the sufficiency and appropriateness of the evidence provided for the understanding of internal control relevant to the audit; and</p> <p>(c) Determine whether complementary user entity controls identified by the service organization are relevant to the user entity and if so, obtain an understanding of whether the user entity has designed and implemented such controls.</p>	<p>Using an Assurance Report from a Service Auditor's Report</p> <p>13. If the user auditor plans to use a type A₁ or type B₂ report as audit evidence about the design and implementation of controls at the service organization, the user auditor shallshould (Ref: para. A189<u>–A12</u>9)</p> <p>{a}₂ evaluate whether the description of controls at the service organization 's system is at <u>'s system is at</u> as of a date or for a period that is appropriate for the user auditor's purposes;</p> <p>{b}₂ evaluate the sufficiency and appropriateness of the evidence provided for the understanding of internal control relevant to the audit; and ₂</p> <p>{c}₂ determine whether complementary user entity controls identified by the service organization are relevant to the user entity and ₁ if so, obtain an understanding of whether the user entity has designed and implemented such controls.</p>	<p>.14 ... If the user auditor decides to use a service auditor's report, the user auditor should consider the extent of the evidence provided by the report about the effectiveness of controls intended to prevent or detect material misstatements in the particular assertions. The user auditor remains responsible for evaluating the evidence presented by the service auditor and for determining its effect on the assessment of control risk at the user organization.</p> <p>.16 The guidance in section 326.06, regarding the auditor's consideration of the sufficiency of audit evidence to support a specific assessed level of control risk is applicable to user auditors considering audit evidence provided by a service auditor's report on controls placed in operation and tests of operating effectiveness. Because the report may be intended to satisfy the needs of several different user auditors, a user auditor should determine whether the specific tests of controls and results in the service auditor's report are relevant to assertions that are significant in the user organization's financial statements. For those tests of controls and results that are relevant, a user auditor should consider whether the nature, timing, and extent of such tests of controls and results provide appropriate evidence about the effectiveness of the controls to support the user auditor's assessed level of control risk. In evaluating these factors, user auditors should also keep in mind that, for certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less support for</p>	

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<p>14. If the user auditor plans to use a Type B report as audit evidence that controls at the service organization are operating effectively, the user auditor shall: (Ref: Para. A20-A28)</p> <p>(a) Evaluate whether the description of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes;</p> <p>(b) Evaluate the sufficiency and appropriateness of the evidence provided about the effectiveness of controls for the relevant assertions;</p> <p>(c) Determine whether complementary user entity controls identified by the service organization are relevant to the user entity, and if so, obtain an understanding of whether the user entity has designed and implemented such controls and, if so, test their operating effectiveness;</p> <p>(d) Evaluate the adequacy of the time</p>	<p>14. <u>A type 2 report may be intended to satisfy the needs of several different user auditors; therefore, specific tests of controls and results thereof in the service auditor's description of tests of controls may not be relevant to assertions that are significant to a particular user entity's financial statements.</u> If the user auditor plans to use information in a type B₂ report as audit evidence that the controls at the service organization are operating effectively, the user auditor should shall: (Ref: Para. A20—A28) <u>perform the procedure in paragraph 13b and the following procedures to determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment:</u> (Ref: par. A21—A28)</p> <p>(a)₂ Evaluate whether <u>(1) the description of controls at the service organization is at a date or's system, and (2) the service auditor's description of tests of controls and results thereof are</u> for a period that is appropriate for the user auditor's purposes;₂</p> <p>(b) Evaluate the sufficiency and appropriateness of the evidence provided about the effectiveness of controls for the relevant assertions;</p> <p>(c)₂ Determine whether complementary user entity controls identified by the service organization are relevant to the user entity; and, if so, obtain an understanding of whether the user entity has designed and implemented such controls and, if so, test their operating effectiveness;₂</p> <p>(d)₂ Evaluate the adequacy of the time-period</p>	<p>control risk reduction the test may provide.</p> <p>.14 ... If the user auditor decides to use a service auditor's report, the user auditor should consider the extent of the evidence provided by the report about the effectiveness of controls intended to prevent or detect material misstatements in the particular assertions. The user auditor remains responsible for evaluating the evidence presented by the service auditor and for determining its effect on the assessment of control risk at the user organization.</p> <p>.16 The guidance in section 326.06, regarding the auditor's consideration of the sufficiency of audit evidence to support a specific assessed level of control risk is applicable to user auditors considering audit evidence provided by a service auditor's report on controls placed in operation and tests of operating effectiveness. Because the report may be intended to satisfy the needs of several different user auditors, a user auditor should determine whether the specific tests of controls and results in the service auditor's report are relevant to assertions that are significant in the user organization's financial statements. For those tests of controls and results that are relevant, a user auditor should consider whether the nature, timing, and extent of such tests of controls and results provide appropriate evidence about the effectiveness of the controls to support the user auditor's assessed level of control risk. In evaluating these factors, user auditors should also keep in mind that, for certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less support for control risk reduction the test may provide.</p>	<p>Paragraph 14 of the ISA ED was revised to</p> <ul style="list-style-type: none"> emphasize that a user auditor using a type 2 report needs to perform the procedure in paragraph 13b in addition to the procedures in paragraph 14 of the SAS. explain why a user auditor needs to perform those procedures.

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<p>period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and</p> <p>(e) Evaluate the specific tests of controls performed by the service auditor and the results thereof relevant to those assertions to determine if sufficient appropriate audit evidence has been obtained about the operating effectiveness of the controls to support the user auditor's risk assessment.</p>	<p>covered by the tests of controls and the time elapsed since the performance of the tests of controls; and.</p> <p>(e)-d. Evaluate <u>whether</u> the specific tests of controls performed by the service auditor and the results thereof <u>as described in the type 2 report are relevant to these assertions to determine if sufficient appropriate audit evidence has been obtained about the operating effectiveness of the controls to support the user auditor's risk assessment</u> assertions in the user entity's financial statements.</p>		
<p>15. In determining the sufficiency and appropriateness of the audit evidence provided by a Type A or Type B report in support of the user auditor's opinion, the user auditor shall be satisfied as to the service auditor's professional reputation, competence and independence. (Ref: Para. A29)</p>	<p>15. In determining the sufficiency and appropriateness of the audit evidence provided by a type A₁ or type B₂ report in support of the user auditor's opinion, the user auditor should shall be satisfied as to <u>concerning</u> the service auditor's professional reputation, competence, and independence. (Ref: para. A29-30-A31)</p>	<p>.18 In considering whether the service auditor's report is satisfactory for his or her purposes, the user auditor should make inquiries concerning the service auditor's professional reputation. Appropriate sources of information concerning the professional reputation of the service auditor are discussed in section 543, Part of Audit Performed by Other Independent Auditors, paragraph .10a.</p>	
<p>16. The user auditor shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion. (Ref: Para. A30)</p>	<p>Reference to the Work of a Service Auditor (Ref: par. A32)</p> <p>16. The user auditor should shall not refer to the work of a service auditor in the user auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion. (Ref: Para. A30).</p>	<p>.21 The user auditor should not make reference to the report of the service auditor as a basis, in part, for his or her own opinion on the user organization's financial statements. The service auditor's report is used in the audit, but the service auditor is not responsible for examining any portion of the financial statements as of any specific date or for any specified period. Thus, there cannot be a division of responsibility for the audit of the financial statements.</p>	<p>Reference to the work of a service auditor in a user auditor's report is not required by law or regulation in the United States.</p>
<p>17. If reference to the work of a service auditor is relevant to an understanding of a modification to the user auditor's opinion, the user auditor's report shall indicate that</p>	<p>17. If reference to the work of a service auditor is relevant to an understanding of a modification to of the user auditor's opinion, the user auditor's report should shall indicate that such reference does not</p>		

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such reference does not diminish the user auditor's responsibility for that opinion. (Ref: Para. A31)	diminish the user auditor's responsibility for that opinion. (Ref: Para. A31)		
<p>Other Audit Evidence Considerations Regarding Service Organizations</p> <p>18. In responding to assessed risks in accordance with ISA 330 (Redrafted), the user auditor shall: (Ref: Para. A32-A35)</p> <p>(a) Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity; and, if not,</p> <p>(b) Perform further audit procedures to obtain sufficient appropriate audit evidence or request the service auditor to perform those procedures on the user auditor's behalf.</p>	<p>Other Audit Evidence Considerations Regarding Service Organizations</p> <p>18. In responding to assessed risks in accordance with ISA 330 (Redrafted) AU section 318, the user auditor shall:should (Ref: para. A323–A356)</p> <p>(a) determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available from records held at the user entity; and, if not,</p> <p>perform further audit procedures to obtain sufficient appropriate audit evidence or requesttask the service auditor <u>through the user entity</u> to perform those procedures on the user auditor's behalf.</p>		
<p>Fraud, Non-Compliance with Laws and Regulations and Uncorrected Misstatements in Relation to Activities at the Service Organization</p> <p>19. The user auditor shall inquire of management of the user entity whether the service organization has reported to the user entity any fraud, non-compliance with laws and regulations or uncorrected misstatements and if so, the user auditor shall evaluate how they affect the nature, timing and extent of the user auditor's further audit procedures. (Ref. Para. A36)</p>	<p>Fraud, Noncompliance With Laws and Regulations, and Uncorrected Misstatements in Relation to Activities at the Service Organization</p> <p>19. The user auditor shallshould inquire of management of the user entity <u>about</u> whether the service organization has reported to the user entity any fraud, noncompliance with laws and regulations, or uncorrected misstatements and. If so, the user auditor shallshould evaluate how they<u>such matters</u> affect the nature, timing, and extent of the user auditor's further audit procedures. (Ref.: para. A367)</p>		
Application and Other Explanatory Material	Application and Other Explanatory Material		

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	<p>Definitions</p> <p>A1. The terms <i>type 1 report</i> and <i>type 2 report</i> have the same meaning as the terms <i>type A report</i> and <i>type B report</i>, respectively, that are used in International Standards on Auditing and International Standards for Assurance Engagements issued by the International Auditing and Assurance Standards Board. (Ref: par. 8)</p>		<p>The terms <i>Type A</i> and <i>Type B report</i> were globally replaced with the terms <i>type 1</i> and <i>type 2 report</i> because existing global practice is to use the terms <i>type 1</i> and <i>type 2 report</i>.</p>
<p>Obtaining an Understanding of the Services Provided by a Service Organization</p> <p><i>Nature of the Services Provided by the Service Organization</i> (Ref: Para. 9(a))</p> <p>A1. A user entity may use a service organization such as one that processes transactions and maintains related accountability, or records transactions and processes related data. Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage bankers that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. The Appendix to this ISA provides examples of some types of service organizations.</p>	<p>Obtaining an Understanding of the Services Provided by a Service Organization</p> <p>Nature of the Services Provided by the Service Organization (Ref: para. 9(a))</p> <p>A24. A user entity may use a service organization, such as one that processes transactions and maintains <u>the related accountability, for the user entity</u> or records transactions and processes related data for the user entity. Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage bankers <u>servicers</u> that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. The Appendix to Exhibit A of this ISA provides <u>SAS contains examples of</u> some types of service organizations.</p>	<p>.03 ... Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage bankers that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. The guidance in this section may also be relevant to situations in which an organization develops, provides, and maintains the software used by client organizations. The provisions of this section are not intended to apply to situations in which the services provided are limited to executing client organization transactions that are specifically authorized by the client, such as the processing of checking account transactions by a bank or the execution of securities transactions by a broker. This section also is not intended to apply to the audit of transactions arising from financial interests in partnerships, corporations, and joint ventures, such as working interests in oil and gas ventures, when proprietary interests are accounted</p>	

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		for and reported to interest holders.	
<p>A2. Examples of service organization services that are relevant to the audit include:</p> <ul style="list-style-type: none"> • Maintenance of the user entity's accounting records. • Management of assets. • Initiating, recording or processing transactions as agent of the user entity. 	<p>A32. Examples of service organization <u>services provided by service organizations</u> that are relevant to the audit include:</p> <ul style="list-style-type: none"> • Maintenance of <u>maintaining</u> the user entity's accounting records. • management of assets. • initiating, recording, or processing transactions as agent of the <u>for</u> user entities. 	<p>.03 ... Service organizations that provide such services include, for example, bank trust departments that invest and service assets for employee benefit plans or for others, mortgage bankers that service mortgages for others, and application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. The guidance in this section may also be relevant to situations in which an organization develops, provides, and maintains the software used by client organizations. The provisions of this section are not intended to apply to situations in which the services provided are limited to executing client organization transactions that are specifically authorized by the client, such as the processing of checking account transactions by a bank or the execution of securities transactions by a broker. This section also is not intended to apply to the audit of transactions arising from financial interests in partnerships, corporations, and joint ventures, such as working interests in oil and gas ventures, when proprietary interests are accounted for and reported to interest holders.</p>	
<p><i>Nature and Materiality of Transactions Processed by the Service Organization and the Degree of Interaction</i> (Ref: Para. 9(b))</p> <p>A3. A service organization may establish policies and controls that affect the user entity's internal control. These policies and controls are at least in part physically and operationally separate from the user entity. The significance of the controls of the service organization to those of the user entity depends on the nature of the services provided by the service organization,</p>	<p>A43. A service organization may establish policies and <u>procedures</u> (controls) that affect the user entity's <u>internal control</u> information and communication systems. These policies and controls are at least in part physically and operationally separate from the user entity. The significance of the controls of <u>at</u> the service organization to those of the user entity's internal control depends on the nature of the services</p>	<p>.06 When a user organization uses a service organization, transactions that affect the user organization's financial statements are subjected to controls that are, at least in part, physically and operationally separate from the user organization. The significance of the controls of the service organization to those of the user organization depends on the nature of the services provided by the service organization, primarily the nature and</p>	

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including the nature and materiality of the transactions it processes for the user entity. In certain situations, the transactions processed and the accounts affected by the service organization may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of those controls is necessary in the circumstances.	provided by the service organization, including the nature and materiality of the transactions it processes for the user entity. In certain situations, the transactions processed and the accounts affected by the service organization may not appear to be material to the user entity's financial statements, but the nature of the transactions processed may be significant and the user auditor may determine that an understanding of those controls is necessary in the circumstances.	materiality of the transactions it processes for the user organization and the degree of interaction between its activities and those of the user organization ...	
A4. The significance of the controls of the service organization to those of the user entity also depends on the degree of interaction between its activities and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organization. For example, a high degree of interaction exists between the activities of the user entity and those at the service organization when the user entity authorizes transactions and the service organization processes and does the accounting of those transactions. In these circumstances, it may be practicable for the user entity to implement effective controls over those transactions. On the other hand, when the service organization initiates or initially records, processes, and does the accounting of the user entity's transactions, there is a lower degree of interaction between the two organizations. In these circumstances, the user entity may be unable to, or may elect not to, implement effective controls over these transactions.	A54. The significance of the controls of the service organization to those of the user entity's <u>internal control</u> also depends on the degree of interaction between the service organization's activities and those of the user entity. The degree of interaction refers to the extent to which a user entity is able to and elects to implement effective controls over the processing performed by the service organization. For example, a high degree of interaction exists between the activities of the user entity and those at the service organization when the user entity authorizes transactions and the service organization processes and does the accounting of <u>accounts for</u> those transactions. In these circumstances, it may be practicable for the user entity to implement effective controls over those transactions. On the other hand, when the service organization initiates or initially records, processes, and does the accounting of <u>accounts for</u> the user entity's transactions, there is a lower degree of interaction between the two organizations. In these circumstances, the user entity may be unable to, or may elect not to, implement effective controls over these transactions.	.06 ... The significance of the controls of the service organization to those of the user organization depends on the nature of the services provided by the service organization, primarily the nature and materiality of the transactions it processes for the user organization and the degree of interaction between its activities and those of the user organization. To illustrate how the degree of interaction affects user organization controls, when the user organization initiates transactions and the service organization executes and does the accounting processing of those transactions, there is a high degree of interaction between the activities at the user organization and those at the service organization. In these circumstances, it may be practicable for the user organization to implement effective controls for those transactions. However, when the service organization initiates, executes, and does the accounting processing of the user organization's transactions, there is a lower degree of interaction and it may not be practicable for the user organization to implement effective controls for those transactions.	
<i>Nature of the Relationship between the</i>	<i>Nature of the Relationship Between the User</i>		

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<p><i>User Entity and the Service Organization</i> (Ref: Para. 9 (c))</p> <p>A5. The contract or service level agreement between the user entity and the service organization may provide for matters such as:</p> <ul style="list-style-type: none"> • The information to be provided to the user entity and responsibilities for initiating transactions relating to the activities undertaken by the service organization; • The application of requirements of regulatory bodies concerning the form of records to be maintained, or access to them; • The indemnification, if any, to be provided to the user entity in the event of a performance failure; • Whether the service organization will provide a Type A or Type B report; and • Whether the user auditor has rights of access to the accounting records of the service organization and other information necessary for the conduct of the audit. 	<p>Entity and the Service Organization (Ref: para. 9(c))</p> <p>A65. The contract or service level agreement between the user entity and the service organization may provide for matters such as:</p> <ul style="list-style-type: none"> the information to be provided to the user entity and the responsibilities for initiating transactions relating to the activities undertaken by the service organization; the application of requirements of regulatory bodies concerning the form of records to be maintained, or access to them; • the indemnification, if any, to be provided to the user entity in the event of a performance failure; • whether the service organization will provide a type A₁ or type B₂ report; and • whether the user auditor has rights of access to the <u>user entity's</u> accounting records of at the service organization and other information necessary for the conduct of the audit. • <u>how the service organization is compensated.</u> 		
<p><i>Nature of the Relationship between the User Entity and the Service Organization</i> (Ref: Para. 9(c))</p> <p>A6. There is a direct relationship between the service organization and the user entity and between the service organization and the service auditor. These relationships do</p>	<p>A76. There is a direct relationship between the service organization and the user entity and between (the user entity enters into an agreement <u>with</u> the service organization) and between the <u>service organization</u> and the service auditor (the <u>service organization engages the service auditor</u>). These relationships do not necessarily create a direct relationship between the user auditor and</p>		<p>These changes clarify the nature of the relationship between (1) the service organization and the user entity and (2) the service organization and the service auditor.</p>

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<p>not necessarily create a direct relationship between the user auditor and the service auditor. When there is no direct relationship between the user auditor and the service auditor, communications between the user auditor and the service auditor are usually conducted through the user entity and the service organization. A direct relationship may also be created between a user auditor and a service auditor, taking into account the relevant ethical and confidentiality considerations. A user auditor, for example, may request a service auditor to perform procedures on the user auditor's behalf, such as:</p> <p>(a) Tests of controls at the service organization; or</p> <p>(b) Substantive procedures on the user entity's financial statement transactions and balances maintained by a service organization.</p>	<p>the service auditor. When there is no direct relationship between the user auditor and the service auditor, Communications between the user auditor and the service auditor are usually conducted through the user entity and the service organization.</p> <p>A8 A direct relationship may also be created between a user auditor and a service auditor, taking into account the relevant ethical and confidentiality considerations. A user auditor, for example, may request a service auditor to through the user entity that a service auditor perform procedures on the user auditor's behalf, such as:</p> <p>(a) Tests of controls at the behalf of the user auditor in addition to reporting on controls. For example, a service auditor may be engaged to perform an agreed-upon procedures engagement related to controls at a service organization; or (b) Substantive procedures on the user entity's financial statement transactions and/or balances maintained by at the service organization. AT section 201, <i>Agreed-Upon Procedures Engagements (AICPA, Professional Standards, vol. 1)</i>, establishes standards and provides guidance for agreed-upon procedures engagements.</p>	<p>.19 ... If the user auditor believes that the service auditor's report may not be sufficient to meet his or her objectives, the user auditor may supplement his or her understanding of the service auditor's procedures and conclusions by discussing with the service auditor the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, he or she may contact the service organization, through the user organization, to request that the service auditor perform agreed-upon procedures at the service organization, or the user auditor may perform such procedures.</p>	<p>Change made to indicate that the request for a service auditor to perform procedures would be made by the user entity on behalf of the user auditor.</p>
<p>Considerations Specific to Public Sector Entities</p> <p>A7. Public sector auditors generally have broad rights of access established by legislation. However, there may be situations where such rights of access are not available, for example when the service organization is located in a different jurisdiction. In such cases, a public sector auditor may need to obtain an understanding of the legislation applicable</p>	<p>Considerations Specific to Public Sector <i>Governmental Entities</i></p> <p>A97. Public sector auditors generally have broad rights of access established by legislation. However, there may be situations where such rights of access are not available, for example when the service organization is located in a different jurisdiction. In such cases, a public sector auditor may need to obtain an understanding of the legislation applicable in the different jurisdiction to determine whether appropriate</p>		<p>This change was made to reflect audit requirements in the United States when auditing a governmental entity, and to refer the user auditor to the appropriate auditing standard for such engagements.</p>

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<p>in the different jurisdiction to determine whether appropriate access rights can be obtained, or ask the user entity to incorporate rights of access in any contractual arrangements between the user entity and the service organization.</p>	<p>access rights can be obtained, or ask the user entity to incorporate rights of access in any contractual arrangements between the user entity and the service organization. For governmental entities, the auditor may be required to perform audit procedures with respect to the entity's compliance with laws and regulations. Such required procedures may include obtaining an understanding of internal control over compliance, performing tests of compliance controls, and performing tests of compliance. Consequently, governmental entities that use a service organization or their auditors may determine that it is appropriate to request that the service auditor perform such compliance-related audit procedures with respect to services provided by the service organization.²</p> <p>² AU section 801, <i>Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance (AICPA, Professional Standards, vol. 1)</i>, addresses audits of an entity's compliance.</p>		
<p>A8. Public sector auditors may also request a service auditor to perform tests of controls or substantive procedures in relation to compliance with legislation or proper authority.</p>	<p>A8. Public sector auditors may also request a service auditor to perform tests of controls or substantive procedures in relation to compliance with legislation or proper authority.</p>		
<p><i>Understanding the Controls Relating to Services Provided by the Service Organization</i> (Ref: Para. 10)</p> <p>A9. The user entity may establish controls over the service organization's services that may be tested by the user auditor and that may enable the user auditor to conclude that the user entity's controls are operating effectively for some or all of the related assertions. If a user entity, for example,</p>	<p>Understanding the Controls Relating to Services Provided by the Service Organization (Ref: para. 10)</p> <p>A10. A9.-The user entity may establish controls over the service organization's services that may be tested by the user auditor and that may enable the user auditor to conclude that the user entity's controls are operating effectively for some or all of the related assertions. If a user entity, for example, uses a service organization to process</p>	<p>.11 ... In doing so, the user auditor may identify certain user organization controls that, if effective, would permit the user auditor to assess control risk below the maximum for particular assertions. Such controls may be applied at either the user organization or the service organization. The user auditor may conclude that it would be efficient to obtain audit evidence about the operating effectiveness of controls to provide a basis for assessing control risk below the maximum.</p>	

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<p>uses a service organization to process its payroll transactions, the user entity may establish controls over the submission and receipt of payroll information that could prevent or detect material misstatements. In this situation, the user auditor may perform tests of the user entity's controls over payroll processing that would provide a basis for the user auditor to conclude that the user entity's controls are operating effectively for the assertions related to payroll transactions.</p>	<p>its payroll transactions, the user entity may establish controls over the submission and receipt of payroll information that could prevent or detect <u>and correct</u> material misstatements. In this situation, the user auditor may perform tests of the user entity's controls over payroll processing that would provide a basis for the user auditor to conclude that the user entity's controls are operating effectively for the assertions related to payroll transactions.</p>	<p>.13 The user organization may establish effective controls over the service organization's activities that may be tested and that may enable the user auditor to reduce the assessed level of control risk below the maximum for some or all of the related assertions. If a user organization, for example, uses a service organization to process its payroll transactions, the user organization may establish controls over the submission and receipt of payroll information that could prevent or detect material misstatements. The user organization might reperform the service organization's payroll calculations on a test basis. In this situation, the user auditor may perform tests of the user organization's controls over payroll processing that would provide a basis for assessing control risk below the maximum for the assertions related to payroll transactions. Alternatively, the user auditor may decide to assess control risk at the maximum level because he or she believes controls are unlikely to pertain to an assertion, are unlikely to be effective, or because he or she believes obtaining evidence about the operating effectiveness of the service organization's controls, such as those over changes in payroll programs, would not be efficient.</p>	
<p>A10. A user entity may use a service organization that in turn uses a subservice organization to perform some of the services provided to a user entity that are part of the user entity's information system as it relates to an audit of the financial statements. The subservice organization may be a separate entity from the service organization or may be related to the service organization. A user auditor may need to consider controls at the subservice organization. In situations where one or more subservice organizations are used, the interaction between the user entity and the service organization is expanded to</p>	<p>A110. A user entity may use a service organization that in turn uses a subservice organization to perform some of the services provided to <u>at</u> the user entity that are part of the user entity's information <u>and communication</u> systems as it relates to an audit of the financial statements. The subservice organization may be a separate entity from the service organization or may be related to the service organization. A user auditor may need to consider controls at the subservice organization. In situations where one or more subservice organizations are used, the interaction between the user entity and the service organization is expanded to include the interaction between the user entity, the service organization,</p>	<p>.05 When a service organization uses a subservice organization, the user auditor should determine whether the processing performed by the subservice organization affects assertions in the user organization's financial statements and whether those assertions are significant to the user organization's financial statements. To plan the audit and assess control risk, a user auditor may need to consider the controls at both the service organization and the subservice organization. Paragraphs .06 through .17 of section 324, <i>Service Organizations</i>, provide guidance to user auditors on considering the effect of a service organization on a user organization's internal control. Although section 324.06-.17 do not specifically refer to subservice</p>	

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include the interaction between the user entity, the service organization and the subservice organizations. The degree of this interaction, as well as the nature and materiality of the transactions processed by the service organization and the subservice organizations are the most important factors for the user auditor to consider in determining the significance of the service organization's and subservice organization's controls to the user entity's controls.	and the subservice organizations. The degree of this interaction, as well as and the nature and materiality of the transactions processed by the service organization and the subservice organizations, are the most important factors for the user auditor to consider in determining the significance of the service organization's and subservice organization's controls to the user entity's controls <u>internal control</u> .	organizations, when a subservice organization provides services to a service organization, the guidance in these paragraphs should be interpreted to include the subservice organization. For example, in situations where subservice organizations are used, the interaction between the user organization and the service organization described in section 324.06 would be expanded to include the interaction between the user organization, the service organization and the subservice organization.	
<p>A11. As noted in ISA 315 (Redrafted),⁵ in respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions and account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. Such automated processing characteristics may be particularly present when the user entity uses service organizations. In such cases, the entity's controls over such risks are relevant to the audit and the user auditor is required to obtain an understanding of such controls in accordance with paragraph 10 of this ISA.</p> <p>⁵. ISA 315 (Redrafted), paragraph 29</p>			
<p><i>Sufficiency of the User Auditor's Understanding</i> (Ref: Para. 11)</p> <p>A12. Information on the nature of the services provided by a service organization may be available from a wide variety of</p>	<p>Sufficiency of the User Auditor's Understanding (Ref: para. 11)</p> <p>A123. Information on <u>about</u> the nature of the services provided by a service organization may be available from a wide variety of sources, such</p>	<p>.09 Information about the nature of the services provided by a service organization that are part of the user organization's information system and the service organization's controls over those services may be available from a wide variety of sources, such as user manuals, system overviews, technical</p>	

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<p>sources, such as:</p> <ul style="list-style-type: none"> • User manuals; • System overviews; • Technical manuals; • The contract between the user entity and the service organization; • Reports by service organizations, internal auditors or regulatory authorities on controls at the service organization; and • Reports by the service auditor, including management letters, if available. 	<p>as:</p> <ul style="list-style-type: none"> • user manuals; • system overviews; • technical manuals; • the contract between the user entity and the service organization; • reports by <u>the</u> service organization's internal auditors or <u>by</u> regulatory authorities on controls at the service organization; and • reports by the service auditor, including management letters, if available. 	<p>manuals, the contract between the user organization and the service organization, and reports by service auditors, internal auditors, or regulatory authorities on the service organization's controls..</p>	
<p>A13. Knowledge obtained through the user auditor's experience with the service organization may also be helpful in obtaining an understanding of the nature of the services provided by the service organization. This may be particularly helpful if the services and controls at the service organization over those services are highly standardized.</p>	<p>A143. Knowledge obtained through the user auditor's experience with the service organization may also be helpful in obtaining an understanding of the nature of the services provided by the service organization. This may be particularly helpful if the services and controls at the service organization <u>and controls</u> over those services are highly standardized.</p>	<p>.09 ... If the services and the service organization's controls over those services are highly standardized, information obtained through the user auditor's prior experience with the service organization may be helpful in planning the audit</p>	<p>This phrase was deleted because "management letters" is not a defined term in the SASs.</p>
<p>A14. A service organization may engage a service auditor to report on the description and design of its controls (Type A report) or on the description and design of its controls and their operating effectiveness (Type B report). Type A and Type B reports are typically reports issued under [proposed] International Standard for Assurance Engagements (ISAE) 3402⁶ or recognized national standards.</p> <p>⁶ [Proposed] ISAE 3402, "Assurance Reports on Controls at a Third Party Service</p>	<p>A154. A service organization may engage a service auditor to report on the <u>description of its system and the suitability of the design of its controls</u> (type A₁ report) or on the <u>description and design of its controls and their system and the suitability of the design and operating effectiveness of controls</u> (type B₂ report). Type A₁ and type B₂ reports are <u>are</u> reports issued under [proposed] International Standard for Assurance Engagements (ISAE) 3402⁶ or recognized national standards <u>AT section XXX,</u>[†] <u>Reporting on Controls at a Service Organization.</u></p> <p>⁶ [Proposed] ISAE 3402, "Assurance Reports on Controls at a Third Party Service Organization."</p>		<p>These changes conform the language in paragraph A15 to the language used in the definitions of <i>type 1</i> and <i>type 2 report</i> in paragraph 8.</p>

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Organization.”	† The number of this Statement on Standards for Attestation Engagements (and subsequent AT section in <i>Professional Standards</i>) will be determined when it is issued as a final standard.		
<p>A15. In some circumstances, a user entity may outsource one or more significant business units or functions, such as its entire tax planning and compliance functions, or finance and accounting or the controllership function to one or more service organizations. The user auditor’s ability to gain an understanding of controls at the service organizations may be dependent on the direct interaction with management at the service organizations, as a report on controls at the service organizations may not be available.</p>	<p>A165. In some circumstances, a user entity may outsource one or more significant business units or functions, such as its entire tax planning and compliance functions, or finance and accounting or the controllership function to one or more service organizations. If a report on controls at the service organization is not available, the user auditor’s ability to gain an understanding of controls at the service organizations may be dependent on the that affect user entities’ internal control may depend on the user auditor’s direct interaction with management at of the service organizations, as a report on controls at the service organizations may not be available.</p>		<p>The first sentence of paragraph A15 of the ISA ED was deleted because it is not needed in this paragraph and is not directly related to the second sentence.</p>
<p>A16. If the user auditor is unable to obtain an understanding of the user entity’s internal control relevant to the audit by performing the procedures required by paragraphs 9-11 of this ISA, the auditor is required to modify the opinion in the auditor’s report.⁷</p> <p>⁷ [Proposed] ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report,” paragraph [9]</p>	<p>A17. Paragraphs .22–.26 of AU section 508, <i>Reports on Audited Financial Statements</i> (AICPA, <i>Professional Standards</i>, vol. 1), provide guidance on modifying the report on controls at the service organizations may not be available. A16. if the user auditor is unable to obtain an understanding of the user entity’s internal control relevant to the audit by performing the procedures required by paragraphs 9–11 of this ISA, the auditor is required to modify the opinion in the auditor’s report.⁷ SAS.</p> <p>⁷ [Proposed] ISA 705 (Revised and Redrafted), “Modifications to the Opinion in the Independent Auditor’s Report,” paragraph [9]</p>		
<p>Assessing the Risks of Material Misstatement (Ref: Para. 12)</p> <p>A17. If a Type B report is not available, a user auditor may contact the service organization, through the user entity, to</p>	<p>Assessing the Risks of Material Misstatement (Ref: para. 12)</p> <p>A187. If a type B₂ report is not available, a user auditor may contact the service organization, through the user entity, to request that a service</p>	<p>.12 A service auditor's report on controls placed in operation at the service organization should be helpful in providing a sufficient understanding to plan the audit of the user organization. Such a report, however, is not intended to provide any evidence of the operating effectiveness of the relevant controls</p>	

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<p>request that a service auditor be engaged to provide a Type B report that includes tests of the operating effectiveness of the relevant controls or to perform procedures that test the operating effectiveness of those controls. A user auditor may also visit the service organization and perform tests of relevant controls if the service organization agrees to it. In all cases, the user auditor's risk assessments are based on the combined evidence provided by service auditor's report and the user auditor's own procedures.</p>	<p>auditor be engaged to provide <u>perform</u> a type B report <u>engagement</u> that includes tests of the operating effectiveness of the relevant controls or to perform <u>agreed-upon</u> procedures that test the operating effectiveness of those controls; <u>for example, procedures a user auditor may perform to test a user entity's controls over the activities of the service organization include independent reperformance of selected items processed by the service organization and tests of the user organization's reconciliation of output reports with source documents.</u> A user auditor may also visit the service organization and perform tests of relevant controls if the service organization agrees to it. In all cases, the user auditor's risk assessments are based on the combined evidence provided by <u>the</u> service auditor's report and the user auditor's own procedures.</p>	<p>that would allow the user auditor to reduce the assessed level of control risk below the maximum. Such audit evidence should be derived from one or more of the following:</p> <ul style="list-style-type: none"> a. Tests of the user organization's controls over the activities of the service organization (for example, the user auditor may test the user organization's independent reperformance of selected items processed by a service organization or test the user organization's reconciliation of output reports with source documents) b. A service auditor's report on controls placed in operation and tests of operating effectiveness, or a report on the application of agreed-upon procedures that describes relevant tests of controls c. Appropriate tests of controls performed by the user auditor at the service organization 	
<p>Using an Assurance Report from a Service Auditor <i>Using a Type A Report</i> (Ref: Para. 13)</p> <p>A18. A Type A report, along with information about the user entity, may be helpful in providing an understanding of:</p> <p>The aspects of controls at the service organization that may affect the processing of the user entity's transactions, including the use of subservice organizations;</p> <p>(b) The flow of significant transactions through the service organization to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur;</p>	<p>Using an Assurance Report from a Service Auditor's Report <i>Using a Type A₁ Report</i> (Ref: para. 13)</p> <p>A18₉. A type A₁ report, along with information about the user entity, may be helpful in providing an understanding of:</p> <p>{a} <u>the aspects of controls at the service organization that may affect the processing of the user entity's transactions, including the use of subservice organizations;</u></p> <p>{b} <u>the flow of significant transactions through the service organization's system to determine the points in the transaction flow where material misstatements in the user entity's financial statements could occur;</u></p>		

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<p>(c) The control objectives at the service organization that are relevant to the user entity's financial statement assertions; and</p> <p>(d) Whether controls at the service organization are suitably designed to prevent or detect processing errors that could result in material misstatements in the user entity's financial statements.</p> <p>A Type A report may be helpful in providing a sufficient understanding to identify and assess the risks of material misstatement of the user entity. Such a report, however, does not provide any evidence of the operating effectiveness of the relevant controls.</p>	<p>(c) the control objectives as stated in the description of the service organization's system that are relevant to the user entity's financial statement assertions; and</p> <p>(d) whether controls at the service organization are <u>implemented and suitably designed</u> to prevent or detect <u>and correct</u> processing errors that could result in material misstatements in the user entity's financial statements. A type A₁ report may be helpful in providing a sufficient understanding to identify and assess the risks of material misstatement of the user entity's <u>financial statements</u>. Such a report, however, does not provide any evidence of the operating effectiveness of the relevant controls.</p>		
<p>A19. A Type A report that is as of a date outside of the reporting period of a user entity may be helpful in providing a user auditor with a preliminary understanding of the controls implemented at the service organization if the report is supplemented by additional current information from other sources. If the service organization's description of controls is as of a date that precedes the beginning of the period under audit, the user auditor may perform procedures to update the information in a Type A report, such as:</p> <ul style="list-style-type: none"> • Discussing the changes at the service organization with user entity personnel who would be in a position to know of such changes; • Reviewing current documentation and 	<p>A20199. A type A₁ report that is as of a date outside of the reporting period of a user entity may be helpful in providing a user auditor with a preliminary understanding of the controls implemented at the service organization if the report is supplemented by additional current information from other sources. If the service organization's description of controls <u>type 1 report</u> is as of a date that precedes the beginning of the period under audit, the user auditor may perform procedures to update the information in a type A₁ report, such as:</p> <ul style="list-style-type: none"> • discussing the changes at the service organization with user entity personnel who would be in a position to know of such changes; • reviewing current documentation and 		

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<p>correspondence issued by the service organization; or</p> <ul style="list-style-type: none"> • Discussing the changes with service organization personnel. 	<p>correspondence issued by the service organization; or</p> <p>discussing the changes with service organization personnel.</p>		
<p><i>Using a Type B Report</i> (Ref: Para. 14)</p> <p>A20. A Type B report may be intended to satisfy the needs of several different user auditors; therefore specific tests of controls and results in the service auditor's report may not be relevant to assertions that are significant in the user entity's financial statements. For those tests of controls and results that are relevant, the nature, timing and extent of such tests of controls are evaluated to determine that the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment. In doing so, the user auditor may consider the following factors:</p> <p>(a) The time period covered by the tests of controls and the time elapsed since the performance of the tests of controls;</p> <p>(b) The scope of the audit and applications covered, the controls tested and tests that were performed, and the way in which tested controls relate to the user entity's controls; and</p> <p>(c) The results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls.</p>	<p>Using a Type <u>B2</u> Report (Ref: para. 14–15)</p> <p>A21.0. A Type B report may be intended to satisfy the needs of several different user auditors; therefore specific tests of controls and results in the service auditor's report may not be relevant to assertions that are significant in the user entity's financial statements. For those tests of controls and results that are relevant, in evaluating the nature, timing and extent of such tests of controls are evaluated relevant to the user entity and results thereof included in a service auditor's type 2 report to determine that whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment. In doing so, the user auditor may consider the following factors:</p> <p>(a) The time period covered by the tests of controls and the time elapsed since the performance of the tests of controls;</p> <p>(b) The scope of the audit and applications covered, the controls tested and, types of tests that were performed, and the way in which tested controls relate to the user entity's controls; and financial statement assertions</p> <p>(c) The results of these tests of controls and the service auditor's opinion on the operating effectiveness of the controls.</p>		<p>Moved the first sentence of paragraph A20 of the ISA ED to paragraph 14 of the proposed SAS because it is needed there to provide an understanding of the requirement.</p>
<p>A21. For certain assertions, the shorter the</p>	<p>A224. For certain assertions, the shorter the</p>	<p>.16 ... For those tests of controls and results that</p>	

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<p>period covered by a specific test and the longer the time elapsed since the performance of the test, the less audit evidence the test may provide. In comparing the period covered by the Type B report to the user entity's financial reporting period, the auditor may conclude that the Type B report offers less audit evidence if there is little overlap between the period covered by the Type B report and the period for which the user auditor intends to rely on the report. When this is the case, a Type B report covering a preceding or subsequent period may provide additional audit evidence.</p>	<p>period covered by a specific test and the longer the time elapsed since the performance of the test, the less audit evidence the test may provide. In comparing the period covered by the type B₂ report to the user entity's financial reporting period, the auditor may conclude that the type B₂ report offers less audit evidence if there is little overlap between the period covered by the type B₂ report and the period for which covered by the user auditor intends to rely on the report entity's financial statements. When this is the case, an <u>additional</u> type B₂ report covering a preceding or subsequent period may provide additional audit evidence.</p>	<p>are relevant, a user auditor should consider whether the nature, timing, and extent of such tests of controls and results provide appropriate evidence about the effectiveness of the controls to support the user auditor's assessed level of control risk. In evaluating these factors, user auditors should also keep in mind that, for certain assertions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less support for control risk reduction the test may provide.</p>	
<p>A22. It may also be necessary for the user auditor to obtain additional evidence about significant changes to the relevant controls at the service organization outside of the period covered by the Type B report or determine additional audit procedures to be performed. Relevant factors in determining what additional audit evidence to obtain about controls at the service organization that were operating outside of the period covered by the service auditor's report may include:</p> <ul style="list-style-type: none"> • The significance of the assessed risks of material misstatement at the assertion level; • The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel; 	<p>A223. <u>If there is little overlap between the period covered by the type 2 report and the period covered by the user entity's financial statements,</u> it may also be necessary for the user auditor to obtain additional evidence about significant changes to in the relevant controls at the service organization during the period outside of the period covered by the type B₂ report, or to determine <u>what</u> additional audit procedures <u>need</u> to be performed. Relevant factors in determining what the additional audit evidence to obtain about controls at the service organization that were operating outside of the period covered by the service auditor's report may include:</p> <ul style="list-style-type: none"> • the significance of the assessed risks of material misstatement at the assertion level; • the specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information <u>and communication systems,</u> processes, and personnel; 		

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<ul style="list-style-type: none"> • The degree to which audit evidence about the operating effectiveness of those controls was obtained; • The length of the remaining period; • The extent to which the user auditor intends to reduce further substantive procedures based on the reliance of controls; • The control environment; and • The effectiveness of the control environment and monitoring controls at the user organization. 	<ul style="list-style-type: none"> • the degree to which audit evidence about the operating effectiveness of those controls was obtained; • the length of the remaining period; • the extent to which the user auditor intends to reduce further substantive procedures based on the reliance of <u>on</u> controls; the control environment; and • the effectiveness of the control environment and monitoring controls at the user organization <u>entity</u>. 		
<p>A23. Additional audit evidence may be obtained, for example, by extending tests of controls over the remaining period or testing the user entity's monitoring controls.</p>	<p>A243. Additional audit evidence may be obtained, for example, by extending <u>performing</u> tests of controls over <u>during</u> the remaining period or testing the user entity's monitoring controls.</p>		
<p>A24. If the service auditor's testing period is completely outside the user entity's financial reporting period, the user auditor will be unable to rely on such tests for the user auditor to conclude that the user entity's controls are operating effectively because they do not provide current audit period evidence of the effectiveness of the controls, unless other procedures are performed.</p>	<p>A254. If the service auditor's testing period is completely outside the user entity's financial reporting period, the user auditor will be unable to rely on such tests for the user auditor to conclude that the user entity's controls are operating effectively because they <u>the tests</u> do not provide current audit period evidence of the effectiveness of the controls, unless other procedures are performed.</p>		
<p>A25. In certain circumstances, a service provided by the service organization may be designed with the assumption that certain controls will be implemented by the user entity. For example, the service may be designed with the assumption that the</p>	<p>A265. In certain circumstances, a service provided by the service organization may be designed with the assumption that certain controls will be implemented by the user entity. For example, the service may be designed with the assumption that the user entity will have controls in place for</p>	<p>.31 It may become evident to the service auditor, when considering the service organization's description of controls placed in operation, that the system was designed with the assumption that certain controls would be implemented by the user organization. If the service auditor is aware of the</p>	

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<p>user entity will have controls in place for authorizing transactions before they are sent to the service organization for processing. In such a situation, the service organization's description of controls may include a description of those complementary user entity controls. The user auditor considers whether those complementary user entity controls are required and whether they are relevant to the service provided to the user entity.</p>	<p>authorizing transactions before they are sent to the service organization for processing. In such a situation, the <u>description of the service organization's description of controls system</u> may include a description of those complementary user entity controls. The user auditor considers whether those complementary user entity controls are required and whether they are relevant to the service provided to the user entity. (Ref: par. 13c)</p>	<p>need for such complementary user organization controls, these should be delineated in the description of controls. If the application of controls by user organizations is necessary to achieve the stated control objectives, the service auditor's report should be modified to include the phrase "and user organizations applied the controls contemplated in the design of the Service Organization's controls" following the words "complied with satisfactorily" in the scope and opinion paragraphs.</p>	
<p>A26. If the user auditor believes that the service auditor's assurance report may not provide sufficient audit evidence, for example, if a service auditor's report does not contain a description of the service auditor's tests of controls and results thereon, the user auditor may supplement the understanding of the service auditor's procedures and conclusions by contacting the service organization, through the user entity, to request discussing with the service auditor the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, the user auditor may contact the service organization, through the user entity, to request that the service auditor perform procedures at the service organization, or the user auditor may perform such procedures.</p>	<p>A276. If the user auditor believes that the service auditor's assurance report may not provide sufficient audit evidence, for example, if a service auditor's report does not contain a description of the service auditor's tests of controls and results thereonf, the user auditor may supplement the<u>his or her</u> understanding of the service auditor's procedures and conclusions by contacting the service organization, through the user entity, to request discussing with the service auditor to <u>discuss</u> the scope and results of the service auditor's work. Also, if the user auditor believes it is necessary, the user auditor may contact the service organization, through the user entity, to request that the service auditor perform procedures at the service organization, or the user auditor may perform such procedures.</p>	<p>.10 After considering the available information, the user auditor may conclude that he or she has the means to obtain a sufficient understanding of internal control to plan the audit. If the user auditor concludes that information is not available to obtain a sufficient understanding to plan the audit, he or she may consider contacting the service organization, through the user organization, to obtain specific information or request that a service auditor be engaged to perform procedures that will supply the necessary information, or the user auditor may visit the service organization and perform such procedures. If the user auditor is unable to obtain sufficient evidence to achieve his or her audit objectives, the user auditor should qualify his or her opinion or disclaim an opinion on the financial statements because of a scope limitation.</p>	
<p>A27. The service auditor's assurance report identifies results of tests, including exceptions and other information that could affect the user auditor's conclusions. Exceptions noted by the service auditor or a modified opinion in the service auditor's assurance report do not automatically</p>	<p>A278. The service auditor's assurance report<u>description of tests of controls</u> identifies results of tests, including exceptions<u>deviations</u>, and other information that could affect the user auditor's conclusions. Exceptions-Deviations noted by the service auditor or a modified opinion in the service auditor's assurance report do not</p>		

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<p>mean that the service auditor's assurance report will not be useful for the audit of the user entity's financial statements in assessing the risks of material misstatement. Rather, the exceptions and the matter giving rise to a modified opinion in the service auditor's assurance report are considered in the user auditor's assessment of the testing of controls performed by the service auditor. In considering the exceptions and matters giving rise to a modified opinion, the user auditor may wish to discuss such matters with the service auditor. Such communication is dependent upon the user entity contacting the service organization, and obtaining the service organization's approval for the communication to take place.</p>	<p>automatically mean that the service auditor's assurance report will not be useful for the audit of the user entity's financial statements in assessing the risks of material misstatement. Rather, the exceptions <u>deviations</u> and the matter giving rise to a modified opinion in the service auditor's assurance report are considered in the user auditor's assessment of the testings <u>tests</u> of controls performed by the service auditor. In considering the exceptions <u>deviations</u> and matters giving rise to a modified opinion, the user auditor may wish to discuss such matters with the service auditor. Such communication is dependent upon <u>through</u> the user entity contacting <u>and</u> the service organization, and obtaining the service organization's approval for the communication to take place.</p>		
<p>Communication of Deficiencies in Internal Control Identified during the Audit</p> <p>A28. The user auditor is required to communicate all deficiencies in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility⁸ and is required to communicate all significant deficiencies with those charged with governance (unless all of those charged with governance are involved in . managing the entity).⁹ Matters that the user auditor may identify during the audit and may wish to communicate to management and those charged with governance of the user entity include:</p>	<p>Communication of <u>Significant Deficiencies and Material Weaknesses</u> in Internal Control Identified <u>During the Audit</u></p> <p>A2928. When assessing a service organization's <u>controls and how they interact with a user entity's internal control relevant to the audit</u>, the user auditor is required to communicate all deficiencies in internal control identified during the audit on a timely basis to management at an appropriate level of responsibility⁸ and is required to communicate all with those charged with governance (unless all of those charged with governance are involved in . managing the entity).⁹ Matters that the user auditor may identify during the audit and may wish to communicate to management and those charged with governance of the user entity include: <u>user entity control deficiencies related to the use of a service organization, for example:</u></p>	<p>.20 When assessing a service organization's controls and how they interact with a user organization's controls, the user auditor may become aware of the existence of significant deficiencies or material weaknesses in internal control. In such circumstances, the user auditor should consider the guidance provided in section 325, <i>Communicating Internal Control Related Matters Identified in an Audit</i>.</p>	

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<ul style="list-style-type: none"> • Any monitoring controls that could be implemented by the user entity, including those identified as a result of obtaining a Type A or Type B report; • Instances where complementary user controls are noted in the Type A or Type B report and are not implemented at the user entity; and • Controls that may be needed at the service organization that do not appear to have been implemented or that are not specifically covered by a Type B report. <p>8 [Proposed] ISA 265, paragraph [9] 9 [Proposed] ISA 265, paragraph [9-10]</p>	<ul style="list-style-type: none"> • Any <u>needed</u> monitoring controls that could <u>have not been</u> implemented by the user entity, including those identified as a result of obtaining a type A₁ or type B₂ report; • Instances where complementary user <u>entity</u> controls are noted <u>identified</u> in the type A₁ or type B₂ report and are not implemented at the user entity; and • Controls that may be needed at the service organization that do not appear to have been implemented or that are not specifically covered by a Type B report <u>were implemented, but are not operating effectively</u> <p><u>If a deficiency in internal control is deemed a significant deficiency or material weakness, the user auditor is required to communicate these deficiencies in writing on a timely basis to management and those charged with governance in accordance with AU section 325, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AICPA, <i>Professional Standards</i>, vol. 1).</u></p> <p>⁸ [Proposed] ISA 265, "Communicating Deficiencies in Internal Control," paragraph [9] ⁹ [Proposed] ISA 265, paragraphs [9-10].</p>		<p>Changes were made to paragraph A28 of the ISA ED to conform with SAS No. 115, <i>Communicating Internal Control Related Matters Identified in an Audit</i> (AICPA, <i>Professional Standards</i>, vol. 1, AU sec. 325).</p>
<p><i>The Service Auditor's Professional Reputation, Competence and Independence</i> (Ref: Para. 15)</p> <p>A29. The user auditor may inquire as to the professional reputation and standing of the service auditor from the auditor's professional organization or other practitioners and inquire whether the</p>	<p>The Service Auditor's Professional Reputation, Competence, and Independence (Ref: para. 15)</p> <p>A3029. The user auditor may inquire as to <u>about</u> the professional reputation and standing of the service auditor from the auditor's professional organization or other practitioners and inquire whether the service auditor is subject to regulatory</p>	<p>.18 In considering whether the service auditor's report is satisfactory for his or her purposes, the user auditor should make inquiries concerning the service auditor's professional reputation. Appropriate sources of information concerning the professional</p>	

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<p>service auditor is subject to regulatory oversight. The service auditor may be practicing in a jurisdiction where different standards are followed in respect of reports on controls at a service organization. In such a situation, the user auditor may inquire about the adequacy of those standards.</p>	<p>oversight. The service auditor may be practicing in a jurisdiction where different standards are followed in^{with} respect of^{to} reports on controls at a service organization. In such a situation, the user auditor may inquire about the adequacy of those standards.</p>	<p>reputation of the service auditor are discussed in section 543, <i>Part of Audit Performed by Other Independent Auditors</i>, paragraph .10a.</p>	
	<p>A31. A service auditor need not be independent of each user entity.</p>	<p>.22 ... Although the service auditor should be independent from the service organization, it is not necessary for the service auditor to be independent from each user organization.</p>	<p>Paragraph A31 was added to the proposed SAS to clarify the issue of independence in a service auditor's engagement.</p>
<p><i>Reference to the Work of a Service Auditor</i> (Ref: Para. 16-17)</p> <p>A30. In some cases, law or regulation may require a reference to the work of a service auditor in the user auditor's report, for example, for the purposes of transparency in the public sector. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference.</p>	<p>Reference to the Work of a Service Auditor (Ref: para. 16-17)</p> <p>A30. In some cases, law or regulation may require a reference to the work of a service auditor in the user auditor's report, for example, for the purposes of transparency in the public sector. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference.</p>		<p>Paragraph A30 of the ISA ED was deleted because this situation is not applicable in the United States.</p>
<p>A31. The fact that a user entity uses a service organization does not alter the user auditor's responsibility under ISAs to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Therefore, the user auditor does not make reference to the service auditor's assurance report as a basis, in part, for the user auditor's opinion on the user entity's financial statements. However, when the user auditor expresses a modified opinion because of a modified opinion in a service auditor's assurance report, the user auditor is not precluded</p>	<p>A32^{A34}. The fact that a user entity uses a service organization does not alter the user auditor's responsibility under ISAs to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Therefore, the user auditor does not make reference to the service auditor's assurance^{assurance examination} report as a basis, in part, for the user auditor's opinion on the user entity's financial statements. However, when the user auditor expresses a modified opinion because of a modified opinion in a service auditor's assurance^{assurance examination} report, the user auditor is not precluded from referring to the service</p>	<p>.21 The user auditor should not make reference to the report of the service auditor as a basis, in part, for his or her own opinion on the user organization's financial statements. The service auditor's report is used in the audit, but the service auditor is not responsible for examining any portion of the financial statements as of any specific date or for any specified period. Thus, there cannot be a division of responsibility for the audit of the financial statements.</p>	

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<p>from referring to the service auditor's assurance report if such reference assists in explaining the reason for the user auditor's modified opinion. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference.</p>	<p>auditor's assurance <u>examination</u> report if such reference assists in explaining the reason for the user auditor's modified opinion. In such circumstances, the user auditor may need the consent of the service auditor before making such a reference <u>and need not identify the service auditor by name.</u></p>		
<p>Other Audit Evidence Considerations Regarding Service Organizations (Ref: Para. 18)</p> <p>A32. When the service organization maintains material elements of the accounting records of the user entity, direct access to those records may be necessary in order for the user auditor to obtain sufficient appropriate audit evidence relating to the operations of controls over those records or to substantiate transactions and balances recorded in them, or both. Such access may involve either physical inspection of records at the service organization's premises or interrogation of records maintained electronically from the user entity or another location, or both. Where direct access is achieved electronically, the user auditor may obtain evidence as to the adequacy of controls operated by the service organization over the completeness and integrity of the user entity's data for which the service organization is responsible. The user auditor may also request the service auditor, on the user auditor's behalf, to gain access to the user entity's records maintained by the service organization.</p>	<p>Other Audit Evidence Considerations Regarding Service Organizations (Ref: para. 18)</p> <p>A332. When the service organization maintains material elements of the accounting records of the user entity, direct access to those records may be necessary in order for the user auditor to obtain sufficient appropriate audit evidence relating to the operations of controls over those records or, to substantiate transactions and balances recorded in them, or both. Such access may involve either physical inspection of records at the service organization's premises or interrogation of records maintained electronically, <u>electronic access</u> from the user entity or another location <u>to electronic records,</u> or both. Where direct access is achieved electronically, the user auditor may obtain evidence as to <u>concerning</u> the adequacy of controls operated by the service organization's <u>controls</u> over the completeness and integrity of the user entity's data for which the service organization is responsible. The user auditor may also request <u>may ask</u> the service auditor, on organization through the user auditor's behalf, <u>on organization</u> through the user auditor's behalf, to gain <u>entity</u> for access to the user entity's records maintained by the service organization.</p>		
<p>A33. In determining the nature and extent</p>	<p>A343. In determining the nature and extent of</p>		

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<p>of audit evidence to be obtained in relation to balances representing assets held or transactions undertaken by a service organization, the following procedures may be considered by the user auditor:</p> <p>(a) Inspecting records and documents held by the user entity: the reliability of this source of evidence is determined by the nature and extent of the accounting records and supporting documentation retained by the user entity. In some cases the user entity may not maintain independent detailed records or documentation of specific transactions undertaken on its behalf.</p> <p>(b) Inspecting records and documents held by the service organization: the user auditor's access to the records of the service organization is likely to be established as part of the contractual arrangements between the user entity and the service organization.</p> <p>(c) Obtaining confirmations of balances and transactions from the service organization: where the user entity maintains independent records of balances and transactions and a service organization processes transactions only at the specific authorization of the user entity or acts only as a simple custodian of assets, confirmation from the service organization corroborating those records usually constitutes reliable audit evidence concerning the existence of the transactions and assets concerned. If the</p>	<p>audit evidence to be obtained in relation to for <u>financial statement assertions about</u> balances representing assets held <u>maintained</u> or transactions undertaken <u>processed</u> by a service organization <u>for a user entity</u>, the following procedures may be considered by the user auditor:</p> <p>(a) <u>Inspecting records and documents held by the user entity:</u> The reliability of this source of evidence is determined by the nature and extent of the accounting records and supporting documentation retained by the user entity. In some cases the user entity may not maintain independent detailed records or documentation of specific transactions undertaken on its behalf.</p> <p><u>Inspecting records and documents held by the service organization:</u> The user auditor's access to the records of the service organization is likely to be established as part of the contractual arrangements between the user entity and the service organization.</p> <p>(c) <u>Obtaining confirmations of balances and transactions from the service organization:</u> Where the user entity maintains independent records of balances and transactions and a service organization processes transactions only at the specific authorization of the user entity or acts only as a simple custodian of assets, confirmation from the service organization corroborating those records usually constitutes reliable audit evidence concerning the existence of the transactions and assets concerned. If the user entity does not maintain independent records, information obtained in confirmations from the service</p>		

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<p>user entity does not maintain independent records, information obtained in confirmations from the service organization is merely a statement of what is reflected in the records maintained by the service organization. Hence such confirmations do not, taken alone, constitute reliable audit evidence. In these circumstances the user auditor considers whether there is a separation of functions for the services provided such that an alternative source of independent evidence can be identified.</p> <p>(d) Performing analytical procedures on the records maintained by the user entity or on the reports received from the service organization: the effectiveness of analytical procedures is likely to vary by assertion and will be affected by the extent and detail of information available.</p> <p>(e) Requesting the service auditor to perform further audit procedures on the user auditor's behalf at the service organization.</p>	<p>organization is merely a statement of what is reflected in the records maintained by the service organization. Hence, such confirmations do not, taken alone, constitute reliable audit evidence. In these circumstances the user auditor considers whether there is a separation of functions for the services provided such that an alternative source of independent evidence can be identified.</p> <p>(d). <i>Performing analytical procedures on the records maintained by the user entity or on the reports received from the service organization:</i>. The effectiveness of analytical procedures is likely to vary by assertion and will be affected by the extent and detail of information available.</p> <p>(e). <i>Requesting the service auditor to perform further audit procedures on the user auditor's behalf at the service organization.</i></p>		
<p>A34. A service auditor may perform procedures that are substantive in nature for the benefit of user auditors. Such an engagement may involve the performance, by the service auditor, of procedures agreed upon by the user entity and its user auditor and by the service organization and its service auditor. The findings resulting from the procedures performed by the service auditor are reviewed by the user auditor to determine whether they constitute sufficient appropriate audit evidence. In addition, there may be requirements imposed by governmental</p>	<p>A354. As noted in paragraph A8, a service auditor may perform procedures under AT section 201 that are substantive in nature for the benefit of user auditors. Such an engagement may involve the performance, by the service auditor, of procedures agreed upon by the user entity and its user auditor and by the service organization and its service auditor. The findings resulting from the procedures performed by the service auditor are reviewed by the user auditor to determine whether they constitute sufficient appropriate audit evidence. In addition, there may be requirements imposed by governmental authorities or through contractual arrangements whereby a service</p>	<p>.17 Service auditors may be engaged to perform procedures that are substantive in nature for the benefit of user auditors. Such engagements may involve the performance, by the service auditor, of procedures agreed upon by the user organization and its auditor and by the service organization and its auditor. In addition, there may be requirements imposed by governmental authorities or through contractual arrangements whereby service auditors perform designated procedures that are substantive in nature. The results of the application of the required procedures to balances and transactions processed by the service organization may be used by user auditors as part of the evidence necessary</p>	

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<p>authorities or through contractual arrangements whereby a service auditor performs designated procedures that are substantive in nature. The results of the application of the required procedures to balances and transactions processed by the service organization may be used by user auditors as part of the evidence necessary to support their audit opinions. In these circumstances, it may be useful for the user auditor and the service auditor to agree, prior to the performance of the procedures, to the audit documentation or access to audit documentation that will be provided to the user auditor.</p>	<p>auditor performs designated procedures that are substantive in nature. The results of the application of the required procedures to balances and transactions processed by the service organization may be used by <u>the</u> user auditors as part of the evidence necessary to support <u>their</u> his or her audit opinions. In these circumstances, it may be useful for the user auditor and the service auditor to agree, <u>establish an understanding</u> prior to the performance of the procedures, to <u>regarding</u> the audit documentation or <u>means of</u> access to the audit documentation that will be provided to the user auditor.</p>	<p>to support their opinions.</p>	
<p>A35. In certain circumstances, in particular when a user entity outsources some or all of its finance function to a service organization, the user auditor may face a situation where a significant portion of the audit evidence resides at the service organization. Substantive procedures may need to be performed at the service organization by the user auditor or the service auditor on behalf of the user auditor. A service auditor may provide a Type B report and, in addition, may perform substantive procedures on behalf of the user auditor. As noted in paragraph A31, the involvement of a service auditor does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Accordingly, the user auditor's consideration of whether sufficient appropriate audit evidence has been obtained and whether the user auditor needs to perform further substantive procedures includes the user auditor's</p>	<p>A365. In certain circumstances, in particular when a user entity outsources some or all of its finance function to a service organization, the user auditor may face a situation where a significant portion of the audit evidence resides at the service organization. Substantive procedures may need to be performed at the service organization by the user auditor or the service auditor on behalf of the user auditor. A service auditor may provide a type B2 report and, in addition, may perform substantive procedures on behalf of the user auditor. As noted in paragraph A342, the involvement of a service auditor does not alter the user auditor's responsibility to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion. Accordingly, the user auditor's consideration of whether sufficient appropriate audit evidence has been obtained and whether the user auditor needs to perform further substantive procedures includes the user auditor's involvement with, or evidence of, the direction, supervision, and performance of the substantive procedures performed by the service auditor.</p>		

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involvement with, or evidence of, the direction, supervision and performance of the substantive procedures performed by the service auditor.			
<p>Fraud, Non-Compliance with Laws and Regulations and Uncorrected Misstatements in Relation to Activities at the Service Organization (Ref: Para. 19)</p> <p>A36. A service organization may be required under the terms of the contract with user entities to disclose to affected user entities any fraud, non-compliance with laws and regulations or uncorrected misstatements attributable to the service organization's management or employees. As required by paragraph 19, the user auditor makes inquiries of the user entity management regarding whether the service organization has reported any such matters and evaluates whether any matters reported by the service organization affect the nature, timing and extent of the user auditor's further audit procedures. In certain circumstances, the user auditor may require additional information to perform this evaluation, and may consider contacting the service organization or the service auditor to obtain the necessary information.</p>	<p>Fraud, Noncompliance With Laws and Regulations, and Uncorrected Misstatements in Relation to Activities at the Service Organization (Ref: para. 19)</p> <p>A376. A service organization may be required under the terms of the contract with user entities to disclose to affected user entities any fraud, noncompliance with laws and regulations, or uncorrected misstatements attributable to the service organization's management or employees. As required by paragraph 19, the user auditor makes inquiries of the user entity management regarding whether the service organization has reported any such matters and evaluates whether any matters reported by the service organization affect the nature, timing, and extent of the user auditor's further audit procedures. In certain circumstances, the user auditor may require additional information to perform this evaluation, and may consider contacting the service organization or the service auditor to obtain the necessary information.</p>		
<p style="text-align: right;">Appendix (Ref: Para. A1)</p> <p>Types of Service Organizations</p> <p>The following are examples of service organizations which perform services that are part of the user entity's information system relevant to financial reporting:</p>	<p style="text-align: right;">Appendix</p> <p>A38.</p> <p><u>Exhibit A: Examples of Service Organizations</u> (Ref: para. A42)</p> <p>Types of Service Organizations</p> <p>The following are examples of service</p>		

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<p>• 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 entities 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.</p> <p>• Transfer agents, custodians, and record keepers 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. Record keepers maintain the financial accounting records of the investment company based on information provided by the transfer agent</p>	<p>organizations which that perform services that are part of the user entity's information system and <u>communication systems</u> relevant to financial reporting:</p> <p>• <i>Trust departments of banks and insurance companies.</i> The trust department of a bank or an insurance company may provide a wide range of services to user entities, 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.</p> <p>• <i>Transfer agents, custodians, and record keepers for investment companies.</i> 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. Record keepers 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.</p>		

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<p>and the custodian of the investment company's investments.</p> <ul style="list-style-type: none"> • 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 entities), and reporting data concerning the mortgage to user entities. • Application service providers. Application service providers generally provide packaged software applications and a technology environment that enable customers to process financial and operational transactions. An application service provider may specialize in providing a particular software package solution to its 	<ul style="list-style-type: none"> • <i>Insurers that maintain the accounting for ceded reinsurance.</i> 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. • <i>Mortgage servicers or depository institutions that service loans for others.</i> 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 entities), and reporting data concerning the mortgage to user entities. • <i>Application service providers.</i> Application service providers generally provide packaged software applications and a technology environment that enable customers to process financial and operational transactions. An application service provider may specialize in providing a particular software package solution to its users, may provide services similar to traditional mainframe 		

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<p>users, may provide services similar to traditional mainframe data center service bureaus, may perform business processes for user entities that they traditionally had performed themselves, or some combination of these services.</p> <ul style="list-style-type: none"> • Internet service providers and Web hosting service providers. Internet service providers enable user entities to connect to the Internet. Web hosting service providers generally develop, maintain, and operate Web sites for user entities. If the user entity is using the Internet or Web site to process transactions, the user entity's information system may be affected by certain controls maintained by the Internet service provider 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. • Third party financial shared service center. A third party financial shared service center enables an entity to centralize finance and administrative operations and handling of financial processing activities to eliminate redundancies and create economies of scale. A third party financial shared service center operates as a stand alone business, treating individual units as customers. 	<p>data center service bureaus, may perform business processes for user entities that they traditionally had performed themselves, or some combination of these services.</p> <ul style="list-style-type: none"> • <i>Internet service providers and Web hosting service providers.</i> Internet service providers enable user entities to connect to the Internet. Web hosting service providers generally develop, maintain, and operate Web sites for user entities. If the user entity is using the Internet or Web site to process transactions, the user entity's information <u>and communication systems</u> may be affected by certain controls maintained by the Internet service provider 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. • <i>Third party financial shared service center.</i> A third party financial shared service center enables an entity to centralize finance and administrative operations and handling of financial processing activities to eliminate redundancies and create economies of scale. A third party financial shared service center operates as a stand alone business, treating individual units as customers. • <i>Payroll Processors.</i> <u>User entities commonly outsource their payroll function to a service organization. The user entity transmits the payroll data (name, address, salary, withholding rate, 401(k) contribution rate, and so on) to the payroll processor either manually or electronically. The payroll processor calculates the amounts for each paycheck, generates the paychecks or executes</u> 		

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	<u>direct deposit instructions, and provides the user entity with the data for the journal entry that records the payroll.</u>		