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Comment letters on on the exposure draft of the proposed statement on auditing standards, Reports on the Processing of Transactions by Service Organizations

American Institute of Certified Public Accountants. Auditing Standards Board

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June 28, 1991

File Ref. No. 1120
4315

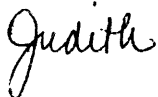
To Members of the Auditing Standards Board:

Here is a composite of the comment letters received on the exposure draft of the proposed statement on auditing standards, *Reports on the Processing of Transactions by Service Organizations*. At the August 1991 meeting, the Auditing Standards Board will discuss significant issues raised in the comment letters. To facilitate that discussion, the Service-Center-Produced Records Task Force will prepare a paper summarizing the significant issues.

I also have enclosed two additional comment letters on the exposure draft. Comment letters 1 through 39 were sent to you in previous mailings.

If I may be of assistance to you, please call me at 212/575-6401.

Sincerely,



Judith Sherinsky
Technical Manager
Auditing Standards Division

Enclosures

cc: Service-Center-Produced Records Task Force



United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

June 14, 1991

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division
File 4315
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The U.S. General Accounting Office (GAO) appreciates the opportunity to comment on the proposed Statement on Auditing Standards (SAS), Reports on the Processing of Transactions by Service Organizations. GAO has a particular interest in any proposed SAS because the 1988 revision of Government Auditing Standards, issued by the Comptroller General of the United States, incorporates the SASs on field work and reporting and provides that future SASs will be incorporated unless GAO excludes them by formal announcement.

Overall, we believe this proposed SAS represents an improvement over SAS No. 44, Special-Purpose Reports on Internal Accounting Control at Service Organizations, which it would supersede. We believe, however, that the Auditing Standards Board should address the following concerns before it issues the final SAS.

First, the Auditing Standards Board should consider whether guidance is needed on how auditors should assess deficiencies in service organizations' internal controls in relation to user organizations' financial statements. Footnote 4 of the exposure draft uses the definition of material weakness from SAS No. 60, Communication of Internal Control Structure Related Matters Noted in an Audit. This sets the service organization's financial statements as the benchmark for assessing the significance of internal control deficiencies. Using this benchmark, is it possible that service auditors could fail to report internal control deficiencies that would be significant for user organizations that are smaller than the service organization? Could, for example, internal control

40a

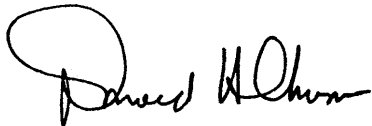
deficiencies that are not significant to the financial statements of a bank processing student financial aid for colleges and proprietary schools be significant to the financial statements of those colleges and schools?

Second, if the final SAS is going to refer to substantive tests, the Auditing Standards Board should provide guidance on service auditors' performance of those tests. The exposure draft raises the issue of substantive testing and testing of compliance with laws and regulations almost as an afterthought. It does not provide guidance to ensure that, in performing these tests, service auditors obtain sufficient evidence to achieve the user auditors' objectives.

User auditors need to be cautioned to read service auditor reports carefully. Often, these reports indicate what the users should be doing to maintain control. The user auditor then can test whether the user is actually doing what the service center requires.

Finally, we suggest that the forthcoming revision of the audit and accounting guide, Audits of Employee Benefit Plans, include the appendix on applying the statement to fiduciaries subject to the requirements of the Employee Retirement Income Security Act.

Sincerely yours,



Donald H. Chapin
Assistant Comptroller General



American Council of Life Insurance

June 17, 1991

Judith Sherinsky
Technical Manager
Auditing Standards Division
File 4315
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

Reports on the Processing of Transactions
by Service Organizations

The American Council of Life Insurance (ACLI) is pleased to comment on the proposed Statement on Auditing Standards, "Reports on the Processing of Transactions by Service Organizations." The ACLI is the major trade association of the life insurance business, representing 616 companies. Together, their assets constitute approximately 92% of the assets of all United States life insurance companies.

As providers of services to employee benefit plans, life insurance companies will be affected by the proposed statement. The guidance in the proposed statement is particularly important because of the possible elimination of the limited scope audit exemption under ERISA for employee benefit plan assets certified by insurance companies, banks, and certain other regulated financial institutions. We generally support the concept of the "single-auditor" approach as a substitute for the limited scope exemption for audits of employee benefit plans that use the services of an insurance company. However, that approach will result in significant costs for insurance companies and plans. Therefore, we believe that the AICPA should carefully consider the costs imposed by the proposed statement and pursue methods to assure the most efficient audit approach consistent with the need for adequate audit evidence.

Need for Comprehensive Guidance for Plan Auditors

The proposed statement establishes standards both for service auditors reporting on a service organization's control structure

and for user auditors regarding the need for and the use of service auditors' reports. The Appendix to the proposed statement provides additional guidance for auditors of employee benefit plans. The AICPA audit guide, "Audits of Employee Benefit Plans," also provides guidance for auditors of employee benefit plans regarding the need for and use of service auditors' reports. We believe that all relevant practical guidance regarding the need for and use of service auditors' reports by plan auditors should be provided in one source, such as in a supplement to the audit guide. Such comprehensive and practical guidance for plan auditors is needed to prevent unnecessary or inappropriate requests by plan auditors for service auditor reports or for the performance of procedures at insurance companies due to misunderstandings of professional standards.

Performance of Procedures by the Plan Auditor at an Insurance Company

Paragraphs 10, 12, and 16 suggest that the plan auditor might consider performing procedures at the insurance company as an alternative or a supplement to performing procedures at the plan or obtaining a service auditor's report. We recommend that those paragraphs be reworded to clearly indicate that visiting the service organization ordinarily should not be considered by the user auditor unless the user auditor concludes that alternative procedures cannot provide sufficient audit evidence. Visits by numerous user auditors are a time-consuming and costly burden for service organizations, and such visits ordinarily are the least efficient audit approach. The proposed statement should indicate that such visits should only be considered after concluding that other methods for obtaining the necessary information are not available.

For example, paragraph 10 could be reworded as follows:

After considering the factors described in paragraph 8 and evaluating the available information about the service organization's policies and procedures described in paragraph 9, the user auditor may conclude that he or she has a means to obtain a sufficient understanding of the internal control structure to plan the audit. If the user auditor concludes that information is not available to obtain a sufficient understanding to plan the audit, the user auditor should consider requesting, through the user organization, that the service organization have its auditor perform procedures to supply the necessary information. If the necessary information cannot be obtained as a result of procedures performed by the service auditor, the user auditor may consider requesting to visit the service organization to perform such procedures. . . .

Similar changes should be made to paragraphs 12 and 16 to indicate the relative hierarchy of alternative procedures.

Paragraph 14 implies that a user auditor may perform tests of controls at a service organization so that the user auditor can assess control risk at less than the maximum. We suggest that this reference to performing procedures at the service organization be deleted. The performance of procedures at the service organization for the purpose cited in paragraph 14 is not necessary to meet the user auditor's audit objectives, and it is unlikely that the performance of such procedures at the service organization would be efficient.

Frequency of Reports on Service Organizations

The proposed statement does not provide specific guidance regarding the frequency of service auditors' reports. The service auditors' reports described by the proposed statement are lengthy and time-consuming documents to prepare. Because the policies and procedures of a service organization may not change significantly from year to year, it may not always be necessary to issue complete service auditors' reports on a frequent basis to meet the needs of user auditors.

To substantially improve the efficiency of the audit process, we recommend that the proposed statement provide a means for service auditors to update previously issued reports. Such updates could be based on inquiries, observations, and inspections to identify changes in the service organization's policies, and appropriate procedures to determine whether the changes in policies and procedures have been placed in operation. Guidance also might be provided for updating reports on tests of operating effectiveness.

The updating of service auditors' reports is consistent with the guidance in SAS 55, "Consideration of the Internal Control Structure in a Financial Statement Audit." Paragraph 53 of SAS 55 provides that "evidential matter about the effective design or operation of internal control structure policies and procedures that was obtained in prior audits may be considered by the auditor in assessing control risk in the current audit." Paragraph 54 of SAS 55 states that, in considering evidential matter obtained in prior audits, the auditor should focus on whether changes have occurred in the internal control structure.

We believe that by permitting the updating of previously issued service auditors' reports by focusing on changes in the control structure, the cost of such reports can be reduced without adversely affecting the information needed by user auditors to perform an effective audit.

4/12

Guidance Regarding Fiduciaries

The Appendix to the proposed statement addresses fiduciaries of employee benefit plans subject to the requirements of ERISA. ERISA section 3(21)(A) defines a fiduciary of an employee benefit plan as among other things, a person who has discretionary authority or control over the assets or administration of a plan.

Life insurance companies may provide various types of services to employee benefit plans ranging from investment management services involving discretionary control over plan assets, to nondiscretionary investment-related services, to various types of administrative services. The audit guide, "Audits of Employee Benefit Plans," describes certain limited circumstances in which a plan auditor might use a service auditor's report regarding investments held by an insurance company. Those circumstances described in the audit guide generally relate to an insurance company having discretionary control over plan assets and, thus, operating in a fiduciary capacity as defined by ERISA.

The proposed statement is not clear as to the use of the term "fiduciary." We recommend that the applicability of the Appendix be clarified and that the proposed statement note that not all providers of services to ERISA plans are fiduciaries.

Procedures to Monitor Compliance with ERISA

Paragraph 6 of the Appendix provides an example of the contents of a report on the description of the control structure related to employee benefit plan accounts of a trustee. Included in the contents is a description of "Procedures Employed to Monitor Adherence to ERISA Requirements for Fiduciaries and Plans." We believe that this description is too broad. ERISA establishes many requirements for the administration of employee benefit plans that may be unrelated to the services provided by a fiduciary. For example, a fiduciary may use data provided by the plan sponsor regarding participants, contributions, and eligibility for benefit payments, but the fiduciary may not have a responsibility to monitor compliance of such matters with ERISA.

Because the Appendix addresses service organizations operating in a fiduciary capacity, we recommend that paragraph 6 be changed to refer to "Procedures Employed to Monitor Adherence to ERISA Requirements Regarding Responsibilities of Fiduciaries."

The Appendix does not explain the purpose of including in a service auditor's report a description of procedures to monitor compliance with ERISA. The inclusion of a reference to compliance with ERISA may raise questions as to the service auditor's and user auditor's responsibility to perform procedures concerning possible illegal acts by a client.


4/d

Paragraph 8 of SAS 54, "Illegal Acts by Clients," provides guidance as to an auditor's procedures concerning possible illegal acts. Those procedures include inquiring of management concerning the client's compliance with laws and regulations and inquiring about the client's policies relative to the prevention of illegal acts. To clarify the service auditor's and user auditor's responsibilities, the Appendix should include a discussion of the purpose of including a description of ERISA compliance procedures in the service auditor's report by reference to the auditor's procedures to inquire about compliance with laws and regulations and related client policies as set forth in SAS 54.

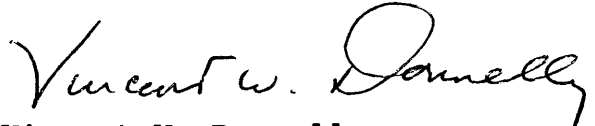
* * * * *

We appreciate the opportunity to comment on the proposed Statement on Auditing Standards, and we would be pleased to answer any questions you may have concerning our comments.

Sincerely,



Stephen W. Kraus
Chief Counsel, Pensions



Vincent W. Donnelly
Actuary

VWD/tmc

File Ref. No. 1120
4315

May 30, 1991

To the Auditing Standards Board:

Here are copies of additional comment letters I have received about the exposure draft of the proposed statement on auditing standards Reports on the Processing of Transactions by Service Organizations. Comment letters 1 through 8 were sent to you in previous mailings.

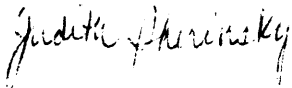
	<u>Name/Affiliation</u>	<u>Location</u>
9.	Margaret Kelley State Auditor of Missouri	Jefferson City, MO
10.	Office of the Legislative Auditor State of Montana	Helena, MT
11.	Thomas H. McTavish State of Michigan Office of the Auditor General	Lansing, MI
12.	Gary L. Holstrum Florida Institute of CPA's	Tallahassee, FL
13.	L. Karl Denton Denton, Netherton & Co., PC	Englewood, CO

Letters 14 through 20 were written by students of the University of North Texas.

14.	Laura Billingsley University of North Texas	Denton, TX
15.	Tracy Chin University of North Texas	Denton, TX
16.	Fred Ganter University of North Texas	Denton, TX
17.	Adiam Ghirmai University of North Texas	Denton, TX

18. Sharon Hogg
University of North Texas
Denton, TX
19. Chita Rath
University of North Texas
Denton, TX
20. Jennifer Shafer
University of North Texas
Denton, TX
21. Maryland Association of CPA's
Baltimore, MD
22. Diann Allsen
State of Wisconsin
Legislative Audit Bureau
Madison, WI
23. Robert Aguallo
California Public Employees'
Retirement System
Sacramento, CA
24. James M. Holloway
South Carolina Association
of CPA's
West Columbia, SC
25. Lawrence R. Beebe
Bond, Beebe, Barton &
Muckelbauer, P.C.
Rockville, MD
26. KPMG Peat Marwick
New York, NY
27. David B. Wick
Massachusetts Mutual Life
Insurance Company
Springfield, MA
28. Brant Hardy
New Hampshire Society of
CPA's
Bedford, NH

Sincerely,



Judith Sherinsky
Technical Manager
Auditing Standards Division

JS:lb

Enclosures

cc: Service-Center-Produced Records Task Force



STATE AUDITOR OF MISSOURI
JEFFERSON CITY, MISSOURI 65102

MARGARET KELLY, CPA
STATE AUDITOR

(314) 751-4824

May 3, 1991

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division, File 4315
American Institute of Certified Public
Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

Enclosed are our comments on the AICPA's exposure draft of a proposed Statement on Auditing Standards, "Reports on the Processing of Transactions by Service Organizations."

If you have any questions regarding our comments, please contact Myrana Gibler, Audit Manager, of my staff at (314) 751-4213.

Sincerely,

A handwritten signature in cursive script that reads "Margaret Kelly".

Margaret Kelly, CPA
State Auditor

Enclosure

**COMMENTS - AICPA EXPOSURE DRAFT - PROPOSED STATEMENT ON AUDITING STANDARDS,
"REPORTS ON THE PROCESSING OF TRANSACTIONS BY SERVICE ORGANIZATIONS"**

The Missouri State Auditor's Office appreciates the opportunity to comment on the AICPA exposure draft.

We believe the guidance in the proposed Statement is more complete and informative than the current guidance in AU Section 324. Among the areas on which the exposure draft provides new or expanded guidance are:

1. Considerations for planning the audit of an entity that uses a service organization (paragraphs 7-10).
2. Reports on the service organization when various exceptions are noted (e.g., significant deficiencies in the design or operation of policies and procedures that preclude the service auditor from obtaining reasonable assurance that stated control objectives would be met) (paragraphs 39-40 and 55).
3. Written representations that the service auditor should obtain from the service organization's management (paragraph 57).

However, we do not expect the proposed Statement to significantly impact our work since most entities that we audit do not use service organizations.

Although we generally support the issuance of the proposed Statement, we offer the following suggestions for improvements:

1. Unnecessary repetition could be eliminated to reduce the length and improve the readability of the document. During our review, we noted several instances of repeated information:
 - a. Although paragraph 2 defines several terms used throughout the document, paragraph 24 repeats the lengthy definitions of the two types of service organization reports.
 - b. Paragraphs 33 and 48 both state that the description of the policies and procedures and the stated control objectives for the service auditor's report may be prepared by the service organization, information which is already apparent in paragraphs 26-28 and 42-43, respectively.
 - c. Much of the information in paragraphs 41-52 and 55 for reports on policies and procedures placed in operation and tests of operating effectiveness is identical to paragraphs 25-37 and 39 for reports on policies and procedures placed in operation. (In this instance, when discussing the second report, the document might simply refer the reader to the discussion of the first report and note any additional information unique to the second.)

- d. Paragraphs 17, 18, 56, and 58 all discuss engaging service auditors to apply substantive procedures to user transactions or assets at the service organization or to perform tests of compliance with laws and regulations affecting the processing of user transactions. Although the first two paragraphs focus on the audit evidence provided by these procedures and the last two on the service auditor's reports, paragraph 17 also refers to reporting.
2. Paragraphs 32 and 47 - The phrase "without error" in the second sentence of each paragraph implies that systems or procedures can provide complete accuracy in accounting and financial reporting. Also, the phrase "such deficiencies" at the end of the sentence appears to be unnecessary since the sentence already refers to deficiencies. Therefore, we suggest the last sentence of the paragraphs be revised as follows:

The service auditor should also consider, irrespective of stated control objectives, whether information comes to his or her attention that causes the service auditor to conclude that design deficiencies exist that could adversely affect the ability to record, process, summarize, or report financial data to user organizations and for which user organizations generally would not be expected to have mitigating policies and procedures in place.

We have also enclosed a marked draft indicating several suggested editorial revisions.

FILE 4315

EXPOSURE DRAFT
PROPOSED STATEMENT ON AUDITING STANDARDS
REPORTS ON THE PROCESSING OF
TRANSACTIONS BY SERVICE ORGANIZATIONS

February 27, 1991
Comment date: May 27, 1991

Name and Affiliation: Office of the Legislative Auditor, State of Montana

Comments: _____

~~We support adoption of the Exposure Draft, Reports on the Processing of Transactions by Service Organizations. In addition to revising standards related to service center audits to reflect audit risk and internal control evaluation precepts in SAS 47 and SAS 55, the draft reorganizes material from SAS 44 to allow easier reference by user auditors. Specifically, paragraph 24 enables the user auditor to identify whether the service center report may enable a reduced level of control risk by identifying the type of report rendered. The draft also allows input by the user organization in determining the scope of the service center audit engagement. Such input should enable the service center auditors to target tests of operating effectiveness to meet needs of the user, the user auditor and the service organization. As an example, the service auditor may perform tests of operating effectiveness at Student Financial Aid service organizations for procedures which ensure compliance with due diligence requirements in federal regulations. From the perspective of the user auditor, the exposure draft represents improved guidance on audits of service organizations.*~~

Instructions for Response Form

This response form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.
Return this response form to the address indicated on the reverse side by the comment date.



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
FAX (517) 334-8079

THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

May 16, 1991

Ms. Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

We have reviewed the Exposure Draft of the proposed Statement on Auditing Standards, entitled Reports on the Processing of Transactions by Service Organizations, and submit the following comments for consideration by the Auditing Standards Board. We have one major comment regarding applicability of the proposed Statement, and have presented our eleven other comments in paragraph number sequence to simplify your review process.

Applicability of the Proposed Statement

Paragraph 3, the applicability paragraph of the proposed Statement, states that "The guidance in this Statement is applicable to the audit of the financial statements of an entity that obtains...services from another organization." However, we do not believe that the paragraph sufficiently defines "another organization," nor does it address a common situation in which the auditor of the user organization(s) is also the auditor of the service organization.

In Michigan, the Office of the Auditor General (OAG) has the constitutional responsibility to audit all branches, departments, boards, commissions, agencies, authorities, and institutions of State government. To fulfill its responsibility, the OAG audits more than four hundred individual State organizations and annually issues approximately one hundred audit reports. The Central Systems Data Center, Department of Treasury, provides data processing services to all nineteen principal State departments. In our opinion, the reporting entity is the State of Michigan; therefore, we do not consider the Central Systems Data Center to be "another organization" within the context of the proposed Statement. However, "another organization" is not clearly defined in the document.

In practice, particularly in small, rural communities, we believe that the user auditor will also frequently be the service auditor, as defined in Paragraph 2 of the Exposure Draft. For example, one certified public accountant may audit all the school districts of a county and the county intermediate school district, which provides data processing services to those school districts. Or, one certified public accountant may audit the local bank, as well as all the local businesses that utilize the bank's data processing services. This situation is not addressed in the proposed Statement.

In both of the above circumstances, the auditor should be expected to follow generally accepted auditing standards, including properly documenting his/her consideration of the service organization on the internal control structure of the user organization. However, recognizing the Board's consideration of the relationship between the cost imposed and the benefits expected to be derived from this guidance, we do not believe that the auditor should be expected to prepare the external reports required by the proposed Statement. Therefore, we strongly recommend that Paragraph 3 be expanded to (1) clearly define "another organization," particularly within the context of the governmental reporting entity, and (2) exempt a service auditor who is also the sole user auditor from the external reporting requirements of the final Statement.

Other Comments

1. The proposed document appears to assume that all service organizations obtain an annual audit by a certified public accountant. While this assumption may be true for the majority of such organizations, we believe that many small, independently-owned service organizations may not presently meet this standard. Therefore, we suggest that the final Statement include a paragraph(s) that recognizes that all service organizations may not be audited annually and provides guidance for the user auditor that encounters that potential situation.
2. Paragraph 8 lists ten bullets as factors the user auditor should consider in planning the audit. The seventh bullet, "The service organization's capability and capacity, including the...record of performance" appears to be somewhat redundant with the eight bullet, "The auditor's prior experience with the service organization." To improve the clarity of the guidance, we suggest that the seventh bullet be expanded to read "The service organization's capability and capacity, including the...record of performance with other users and/or reputation in the business community."
3. During our review of the Exposure Draft, we noted numerous instances of apparent inconsistent use of terminology, such as the phrases "report on policies and procedures" and "report on control structure policies and procedures." For example, in Paragraph 14, "the auditor" should be "the user auditor," and "another independent auditor" is inconsistent with the standard term "service auditor" used throughout the document. To improve clarity and readability, we suggest that all paragraphs of the final document, to the extent possible, contain consistent terminology.
4. The first sentence of Paragraph 28 states "Although a service auditor's report on policies and procedures placed in operation is as of a specified date, the service auditor should inquire about changes in the service organization's policies and procedures that may have occurred before the beginning of fieldwork." The phrase "...that may have occurred before the beginning of fieldwork" is confusing when read in the context of the previously-mentioned "specified date." For consistency

and clarity, we suggest that this phrase be revised, depending on the Board's intent, to read either "...that may have occurred before the specified date" or "...that may have occurred subsequent to the specified date but before the beginning of fieldwork."

5. The first bullet of Paragraphs 28 and 43 states "Procedural changes made to accommodate provisions of a new Statement of Financial Accounting Standards." If the proposed Statement is applicable to audits of state and local governmental entities, we suggest that this bullet be revised to read either "Procedural changes made to accommodate provisions of a new accounting standard" or "Procedural changes made to accommodate provisions of a new Statement of Financial Accounting Standards or Statement of Governmental Accounting Standards."
6. The three bullets of Paragraphs 28 and 43 all illustrate positive changes (such as the elimination of deficiencies) in the service organization's policies and procedures. To properly reflect actual situations, we suggest that an additional bullet, which illustrates a negative change, be added. For example, the additional bullet could read "Procedural changes to by-pass selected clerical controls due to a reduced level of staffing."
7. Paragraph 30 states "If the service auditor believes that the description is inaccurate or is not sufficiently complete for user auditors, his or her report should so state, and should give sufficient detail to provide users with an appropriate understanding." The last phrase of the sentence is unclear whether the "appropriate understanding" refers to the description of policies and procedures or to the inaccuracy and/or missing information. Therefore, we suggest that Paragraph 30 be revised to include a clearer meaning of the phrase "appropriate understanding."
8. Paragraph 38, which presents the service auditor's sample report on policies and procedures, states that "It should be assumed that the report has, as an attachment, a description of those policies and procedures at the service organization that may be relevant to a user's internal control structure." However, the proposed statement does not include an example of a standard description, nor does Paragraph 38 refer to other illustrations, such as in the appendices of the AICPA Audit and Accounting Guide, Audits of Service-Center Produced Records. To provide the auditor with sufficient guidance on the form and content of the description of policies and procedures, we suggest that either the final Statement include an example of a standard description as an appendix, or that Paragraph 38 include a reference to the examples in the AICPA Audit and Accounting Guide or other professional literature.
9. Paragraph 40 provides guidance on the revisions in the sample report for circumstances in which the scope of the engagement is limited to exclude an opinion on the suitability of the design of the control structure policies and


Ms. Judith Sherinsky
Page 4
May 16, 1991

procedures to meet the control objectives. To provide more specific guidance on which paragraphs in the report require revision, we suggest that the third paragraph of Paragraph 40 be revised to read "In addition, the following sentences would be deleted from the fourth and fifth paragraphs, respectively, of the sample report."

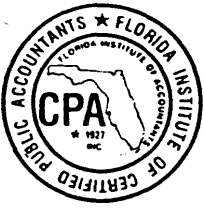
10. Paragraph 56, entitled "Other Information in Service Auditors' Reports," and Paragraph 58, entitled "Reporting on Substantive Procedures or Compliance With Laws and Regulations," appear to be redundant and, therefore, very confusing. The initial guidance, identical in both paragraphs, is "The service auditor may also be requested to apply substantive procedures to user transactions or assets at the service organization or to perform tests of compliance with laws and regulations affecting the processing of user transactions. In such circumstances..." To improve the clarity of the final Statement, we suggest that the guidance in Paragraphs 56 and 58 be merged into one paragraph, with appropriate subdivisions, if necessary. We also suggest that the Board consider including illustrative examples of the required description and the required separate report in the final Statement, as discussed in Paragraphs 56 and 58, respectively.
11. Paragraphs 28 and 43 both contain the statement that "Changes that occurred more than twelve months before the date being reported on normally would not be considered significant because they generally would not affect user auditors' procedures." To provide consistent guidance within the final Statement and to acknowledge that some examinations may be less frequent than annually, we suggest that the third bullet of Paragraph 57 (regarding written representations of management) be revised to read "State that management has disclosed to the service auditor any significant changes in policies and procedures that have occurred within the last twelve months or since the organization's last examination, whichever is more recent."

We appreciate this opportunity to comment on the proposed Statement on Auditing Standards. Should you have any questions, or desire further details on our comments, please contact me or Jon A. Wise, C.P.A., Director of Professional Practice.

Sincerely,



Thomas H. McTavish, C.P.A.
Auditor General



FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

325 WEST COLLEGE AVENUE • P.O. BOX 5437 • TALLAHASSEE, FLORIDA 32314
TELEPHONE (904) 224-2727 • FAX (904) 222-8190

May 21, 1991

Ms. Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

The Accounting and Auditing Standards Committee of the Florida Institute of Certified Public Accountants has considered the AICPA Auditing Standards Board's February 27, 1991 Exposure Draft (ED) "Reports on the Processing of Transactions by Service Organizations." This letter of comment is based on our committee's discussion of the ED in a recent meeting attended by ten committee members. The ten committee members who participated include seven members in public practice and three members in academia.

The committee would like to provide the Division with the following suggestions:

OVERALL

Our committee supports the issuance of this standard.

PARAGRAPH 10

The last sentence concerning a scope limitation would be more effective if there was a crossover reference to SAS 55 concerning auditability.

Ms. Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
May 21, 1991
Page 2

We appreciate the opportunity to comment on the exposure draft and hope that our suggestions are of value in the final issuance of the statement.

Sincerely,



Gary L. Holstrum, PhD., C.P.A., Chairman
The Accounting Principles and Auditing
Standards Committee of the Florida
Institute of Certified Public Accountants
(813) 974-4186

Members of Task Force to Draft
Comment Letter:

Edward J. Leonard, C.P.A. (813) 748-1040

EJL/st

Received 5/3/91 @ 4:55 pm

EXPOSURE DRAFT

FILE 4315

PROPOSED STATEMENT ON AUDITING STANDARDS

REPORTS ON THE PROCESSING OF TRANSACTIONS BY SERVICE ORGANIZATIONS

February 27, 1991

Comment date: May 27, 1991

Name and Affiliation: Laura Billingsley, Graduate Accounting Student
University of North Texas

Comments:

Paragraphs 3, 12, and 13 use the term 'EDP.' This term is outdated and should be replaced with the term 'computer.'

Paragraph 19: The user auditor should also investigate changes that may have occurred in the service organization's policies and procedures subsequent to the service auditor's report.

Instructions for Response Form

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Tracy Chin
Extra Credit Assignment

COMMENTS ON THE EXPOSURE DRAFT:

* Overall, the term EDP should not be used in the standards as it is obsolete and not applicable for organizations today.

* This proposed statement has included specific guidance (in paragraph 3) and steps (in paragraph 4) for the user auditor to plan the audit. I find this clarifies the procedures that are to be taken.

* The user auditor is suggested two specific action plans to gather sufficient understanding of the internal control structure to plan the audit. If evidence is inadequate to understand the structure, then a specific action is suggested. I find this suggestions useful to explain what the user auditor should do in situations like these.

* The last sentence in paragraph 14 can clarify the position of the user auditor to students and practitioners. The emphasis on the user auditor's responsibility in determining the adequacy of the service report indicates the importance of this evaluation and any effects it might have on the audit.

* The last sentence in paragraph 16 emphasizes the relationship of the period covered in a test with the reduction of control risk. I find this explanation useful as it clarifies the importance of considering the period covered.

* In paragraph 15, I think past audits should also be included in assessing control risk. In less volatile industries (not S&L industry), most past audits with a few new changes can reduce some tests of controls.

* I doubt the ability of the user organization in instructing the service auditor to perform some procedures the user organization wants as stated in paragraph 17. Does the user organization have the authority to instruct the service auditor? Unless this authority is specified in the service contract, I think this step is difficult to achieve. Moreover, the service auditor is employed by the service organization to prepare reports on processing of transactions for many user organizations' auditors. It is difficult to perform different type of procedures for each user organization.

SAS 44
Exposure Draft

Comments

Fred Ganter

-- The title is an improvement. By saying "processing of transaction" one imagines a DP service, which is what many service organizations are. In the same sense, deleting "Internal Accounting Control" is good because the reader now imagines all management, not just the accountants, as responsible for the financial statements.

-- The term EDP is obsolete. Computer processing or data processing would better serve.

-- Changing "client organization" to "user organization" is good for consistency. Defining the reports immediately after terms is also good.

-- Paragraph 3 is worded much better.

-- Having a paragraph on significance is an excellent idea. This paragraph is much better worded than the original.

-- Why paragraph 7? It provides no further information that is not covered in SAS 55. It, consequently, causes the reader to wonder if this is "padding."

-- The section "Planning the Audit" warrants an example. In fact, the entire statement is lacking adequate up-to-date examples.

-- What happened to the section "Service Organizations" That

Maintain controls that do not interact with client organization controls." Aren't these organizations around anymore?

-- The entire statement has better divisions (subtitles).

-- The two types of reports in paragraph 24 are much easier to understand than the 3 in the current SAS 44. Bravo!

-- Hasn't paragraph 51 already been stated in other SASs? These concepts are fundamental to any audit; not just service organization audits.

-- Why eliminate "Examples of Service Organizations"?

EXPOSURE DRAFT
PROPOSED STATEMENT ON AUDITING STANDARDS
REPORTS ON THE PROCESSING OF
TRANSACTIONS BY SERVICE ORGANIZATIONS

FILE 4315

February 27, 1991
Comment date: May 27, 1991

Adnan Girmaci

Name and Affiliation:

Comments:

- * The incorporation of audit risk concept in SAS #47 and terminology and concepts of SAS #55 will make the new standard broader and more comprehensive. The obsolete terminologies will be updated by the new standard so that the public could comprehend it better than before.
- * I believe that the requirement of six month period of coverage for reports expressing an opinion on a description of policies and procedures placed in operation at a service organization is a good idea, because it allows the auditor to test whether the policies and procedures were placed in operation just because the company was going to be audited. But if the auditor did an interim test and goes back and tests the policies and procedures placed in operation, the auditor could rely on the policies and procedures and report that they are operating effectively. It also gives a

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Comments (continued):

minimum requirement while before there was no coverage period for reporting on policies and procedures placed in operation.

* Not including report on a segment of a service organization will reduce redundancy in reporting. When the auditor reports on a service organization as a whole, the segment of a service organization is included there. So the auditor report on a service organization as a whole is sufficient to meet the objectives of internal accounting control of a segment of a service organization.

Return responses to:

AICPA

**Judith Sherinsky, Tech. Mgr.
Auditing Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775**

FILE 4315

EXPOSURE DRAFT
PROPOSED STATEMENT ON AUDITING STANDARDS
REPORTS ON THE PROCESSING OF
TRANSACTIONS BY SERVICE ORGANIZATIONS

February 27, 1991
Comment date: May 27, 1991

Name and Affiliation: Sharon Hogg GRADUATE STUDENT - ACCOUNTING
UNIVERSITY OF NORTH TEXAS

Comments:

① On incorporation of audit risk concept of SAS 47 and terminology and concepts of SAS 55:

- ties overall audit risk concept to this specific situation and views it in these terms. More clearly emphasizes the nature of audit risk in this situation

- adds more consistency in terminology and concepts between SAS's 44 and 55. Links them in a manner that makes understanding the connection easier.

② On minimum 6mo. period of coverage:

- may give more credibility to reports, as a lengthened period is covered in the report.

③ on no longer requiring separate reports for segments of service organizations:

- It appears that the issues addressed and covered in this report are also covered in other areas. Not requiring this report will

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Comments (continued):

decrease paperwork and time for the auditor if
adequate provisions are made to supply guidance
in the assessment of controls in the specific
areas that were addressed by this report.

Return responses to:
AICPA
Judith Sherinsky, Tech. Mgr.
Auditing Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775

Chitra Rath

AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

April 28, 1991

I am pleased to provide my opinion on the Exposure Draft, approved by the Auditing Standard Board. I feel the proposed statement provides adequate guidance on the factors an auditor should consider when auditing the financial statements of an entity that uses a service organization. The following are a few issues in the statement, I felt the need to comment specifically.

1) The proposed statement's introduction of changes in concepts and terminologies in accordance with SAS 55 seems to be the right thing. The term "internal control structure", consisting of control environment, the accounting system and control procedures is a concept, I feel the auditors need to recognize when dealing with service center reports.

2) The definition of "service auditor" could be better explained because a service auditor, I feel can be engaged to provide a broader range of services.

3) The statement does not make appropriate recommendation as to when the auditor should obtain audit evidence from a service organization. In paragraph 12, the statement mentions about obtaining evidential matter but does not mention the timing of obtaining evidence.

4) In paragraph 28, The statement does not provide enough practical guidance on the additional procedures an auditor should carry out when the service auditor's report does not cover an entire financial period or to deal with the possibility that changes affecting an enterprise were discovered by the service auditor but not reported because they were not considered significant.

5) The scope paragraph of the service auditor's report states that examination was made in accordance with standards established by AICPA. I feel the service auditor's report should state that the examination was made in accordance with generally accepted auditing standards (GAAS).

Overall I feel the exposure draft provides description of the form and content for the user auditor report and the service auditor report type and its associated level of reliance. The user auditor's responsibilities and risks have also been

adequately explained in this draft. User and service auditors should obtain necessary guidance on the factors they need to consider when developing their reports.

EXPOSURE DRAFT
PROPOSED STATEMENT ON AUDITING STANDARDS

FILE 4315

REPORTS ON THE PROCESSING OF
TRANSACTIONS BY SERVICE ORGANIZATIONS

February 27, 1991

Comment date: May 27, 1991

Name and Affiliation: Jennifer Shafer

Comments:

[2] The use of "user" organization and "user" auditor is preferable to "client" organization and "client" organization as previously used. The former use is less ambiguous when discussing the responsibilities of the different auditors to their respective auditee organizations.

[2] The definition of "Report on policies and procedures placed in operation" and "Report on policies and procedures placed in operation and tests of operating effectiveness" are repeated in paragraph 24.

[3] The application of the Standard to those "situations in which an organization develops, provides, and maintains the software being used by client organizations" is responsive to the growing need for guidance in the audit the software vendors who may not be directly involved with the execution or recording of transactions.

[7] For new auditors confused by the concepts and obsolete terminology used in the current SAS 44, the inclusion of SAS 55 concepts and terminology is extremely beneficial.

[23] This paragraph states that the service auditor should be independent from the service organization. Many service organizations have competent internal auditors that could independently perform the same audit work and prepare the reports as described in later paragraphs. The standard does not give guidance on the use of such internal audit reports when the audit situation involves a service organization.

[29] & [44] The service audit report checklists provide guidance on the necessary elements that the service auditor must include in the report and on the necessary information that the user auditor must ascertain from the report.

[38] & [39] & [40] & [54] & [55] The inclusion of illustrative reports provide beneficial guidance on reporting format to service auditors conducting audits upon the service organization's policies and procedures placed in operations (and tests of operating effectiveness).

FILE 4315

EXPOSURE DRAFT
PROPOSED STATEMENT ON AUDITING STANDARDS
REPORTS ON THE PROCESSING OF
TRANSACTIONS BY SERVICE ORGANIZATIONS

February 27, 1991
Comment date: May 27, 1991

Name and Affiliation: MARYLAND ASSOCIATION OF CERTIFIED PUBLIC ACCOUNTANTS
AUDITING STANDARDS COMMITTEE

Comments: _____

P11 #15 THE FOLLOWING SHOULD BE ADDED:

"USOC MAY CONSIDER PERFORMING ADDITIONAL
PROCEDURES TO UPDATE A SERVICE AUDITORS
REPORT TO THE USOC AUDITORS AUDIT DATE"

P11 #39

ALL DEFICIENCIES SHOULD BE DOCUMENTED,
BECAUSE THE SERVICE AUDITOR MAY THINK SOMETHING
IS NOT SIGNIFICANT, BUT THE USOC AUDITOR MAY
FEEL IT IS SIGNIFICANT.

P11 #40

THIS PARAGRAPH APPEARS TO GIVE THE SERVICE AUDITORS
THE ABILITY TO ISSUE ONE REPORT THE FIRST
YEAR AND A DIFFERENT LEVEL THE SECOND YEAR
THE COMMITTEE BELIEVES THIS PARAGRAPH SHOULD
BE ELIMINATED

Instructions for Response Form

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Comments (continued):

THE COMMITTEE BELIEVES THERE SHOULD BE A
CLARIFICATION OF THE MINIMUM SIX MONTH
REPORT

Return responses to:

AICPA

Judith Sherinsky, Tech. Mgr.
Auditing Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775



May 21, 1991

Ms. Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
American Institute of Certified
Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

We have completed our review of the proposed Statement on auditing standards entitled "Reports on the Processing of Transactions by Service Organizations", and appreciate the opportunity to respond to the Statement. Generally, we find the provisions of the Exposure Draft (ED) to be adequate, and do not anticipate any significant implementation problems for our audits of the State of Wisconsin. However, we believe several areas of the ED need additional clarification. Our comments and suggestions are listed below.

1. The central issue of the ED concerns obtaining reports on the service organization's internal control policies and procedures from the service auditor to assist the user auditor in developing an understanding of the internal control structure, and, in some cases, assessing the associated control risk. Since the proposed Statement implies that a service auditor's report would initially be prepared at the request of the service organization, we believe it would be helpful if the ED specifically explained the proper method of contacting the service organization to communicate the needs of the user auditor. This would avoid confusion as to who (service organization, service auditor, or user organization) is responsible for providing this information to the user auditor.

Related to this comment, we question the feasibility of a user auditor requesting the service auditor to perform additional audit work, as suggested in paragraph 20. It is doubtful, particularly in the governmental environment, that a service auditor would perform additional procedures at the request of a user auditor.

2. We are concerned that the ED appears to provide less guidance concerning effects of the timing of the service auditor's report than is given in SAS 44 (paragraph 23). Paragraph 15 notes that in assessing control risk, "the user auditor should consider the nature, source, and interrelationships among the evidence, as well as the period covered by the tests of controls." If the period covered by the service auditor's report does not coincide with the financial statement period audited by

the user auditor, it appears the user auditor should follow the guidance of SAS 55 in obtaining audit evidence related to the interim period. It may be helpful for the proposed Statement to clearly address this issue and also provide specific direction on the service auditor's responsibility for subsequent events.

3. Paragraph 22 states that "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." While the rationale for not making reference to the service auditor in the user auditor's opinion is clearly explained in the ED, we question whether the same rationale should be applied to a report on the internal control structure prepared by the user auditor for the user organization. Specifically, if a service auditor's report notes that a significant deficiency exists in the design or operation of the service organization's policies and procedures, and the user auditor determines that the deficiency represents a reportable condition of the user organization, should the user auditor again make no reference to the service auditor's report in his or her report on the internal control structure?
4. The provisions of paragraphs 32 and 36 appear inconsistent. Paragraph 32 states that the "service auditor should also consider, irrespective of stated control objectives, whether information comes to his or her attention that causes the service auditor to conclude that there are design deficiencies that could adversely affect the ability to record, process, summarize, or report financial data to the user organizations without error..." However, paragraph 36 states that the service auditor's report should "refer only to the suitability of the design of control structure policies and procedures intended to accomplish specific control objectives and not to the suitability of the design of applications or processes to meet objectives beyond the specifically identified control objectives." We believe that, as stated, paragraph 36 could result in certain design deficiencies, which could affect the data submitted by the service organization to the user organization and should be conveyed to the user auditor, not being included in the service report because the deficiency may be related to objectives beyond specifically identified control objectives. We note a similar inconsistency in paragraphs 47 and 51.
5. It also appears that the provisions of paragraphs 56 and 58 are inconsistent. The first sentence of each paragraph addresses substantive procedures which may be applied to user transactions or assets by the service auditor. The language used in each sentence is identical, yet paragraph 56 recommends a description of such tests be included in the service auditor's report, while paragraph 58 directs that the description should be included in a separate report. We

Ms. Judith Sherinsky
Page 3
May 21, 1991

believe that additional clarification is necessary to clearly define the proper reporting format to be used when a service auditor applies substantive tests or tests of compliance with applicable laws and regulations relating to user transactions.

If you have any questions or comments, please feel free to contact Carol Fraedrich at (608) 266-2818.

Sincerely,



Diann Allsen
Financial Audit Director



Audits Division
P.O. Box 942701
Sacramento, CA 94229-2701
(916) 326-3845

May 23, 1991

Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
American Institute of CPAs
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Dear Ms. Sherinsky:

This letter represents the response of the Master Custody Review Task Force of the California Public Employees Retirement System (PERS) concerning the exposure draft on the proposed new auditing standard on "Reports on the Processing of Transactions by Service Organizations."

PERS is one of the nation's largest retirement systems, with over 650,000 members from 1,200 contracting public agencies in California. In addition, the PERS Board of Administration administers a health benefits program with more than 315,000 members from 650 contracting public agencies within the state.

The Master Custody Review Task Force was established to review the effectiveness and efficiency of custody arrangements and procedures with the master custodian (The Boston Company) of PERS' assets. The Task Force members consist of several PERS Board members and staff from PERS, The Boston Company, the State Controller's Office and the State Treasurer's Office. Also, advisors and consultants from the State Office of the Auditor General, the State Department of Finance, and Coopers & Lybrand provide advice and assistance.

As a part of our review of custodial services for our investments of over \$63 billion, we had to assess the comfort level obtained from reports by the external auditor of the master custodian. It was our general impression that a so-called "third party" letter was not a very helpful tool in assessing certain control risks. We think that the proposed auditing standard is an improvement over the existing standard because it focuses the service auditor's and the user auditor's attention on the control objectives and the control risks. By making the control objectives and the related policies and procedures an explicit part of the auditor's report, the report becomes more useful to the user auditor and to other interested parties as well.

We also found the discussion of factors to be considered by the user auditor in planning the audit to be very helpful for our review of the master custodian. Overall, the presentation of the proposed standard is also better structured and is thus easier to follow than SAS No. 44. However, we found one paragraph that we think may be in error. Paragraph 56 refers to the same circumstances as paragraph 58, but does not require reporting in accordance with SAS No. 35. The first sentence in paragraph 56 should obviously refer to other information rather than to substantive and other testing procedures.

In conclusion, we were very pleased with the overall quality of the exposure draft and the usefulness of the proposed auditing standard. If you have any questions concerning our response, please contact Val Anderson, Chief, Audits Division at (916) 326-3833.

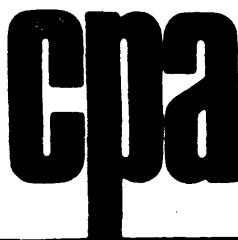
Sincerely,



Robert Aguallo, Chairman
Master Custody Review Task Force
California Public Employees Retirement System

cc: Master Custody Review Task Force
Judy Lee, STRS
Richard Winder, STRS

RA:VA:wdp



South Carolina Association
of Certified Public Accountants
570 Chris Drive
West Columbia, SC 29169
(803) 791-4181

May 24, 1991

Ms. Judith Sherinsky
Technical Manager
AICPA Auditing Standards Division, File 4315
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

The Technical Standards Committee of the South Carolina Association of Certified Public Accountants has reviewed the Exposure Draft of the proposed statement on auditing standards "Reports on the Processing of Transactions by Service Bureaus". We believe the proposed statement will provide useful guidance to practitioners engaged in the audit of entities using service organizations to process transactions and to auditors issuing reports on procedures performed at service organizations for use by other auditors.

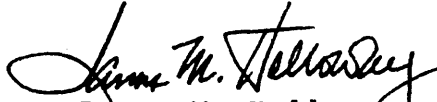
Our specific comments to the Exposure Draft (the ED) are in the following areas:

(1) We concur with the ED as it is presently written. We believe the availability of two levels of reporting will provide flexibility to user auditors to plan and perform a cost efficient audit. The ED represents an improvement over existing literature.

(2) Our committee has concerns with implementation and communication issues which are beyond the scope of the Board's control. These issues relate primarily to increased costs paid by the servicer that are associated with the testing of effectiveness and how these costs will be balanced with presumed efficiencies (reduced audit costs) realized by users resulting from assessments of control risk at less than maximum. We believe that economic considerations and unrelated factors such as the availability of processing alternatives may eventually limit the impact of this proposed standard.

Thank you for the opportunity to comment.

Very truly,



James M. Holloway CPA
Chairman, Technical Standards Committee
South Carolina Association of
Certified Public Accountants

cc: Members of the Committee
C. John Wentzell, CPA
Lollie B. Coward, SCACPA



Bond, Beebe, Barton & Muckelbauer, P.C.

May 23, 1991

Ms. Judith Sherinsky, Technical Manager
Auditing Standard Division, File 4315
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mrs. Sherinsky:

This is in response to the exposure draft on Reports on the Processing of Transactions by Service Organizations. I am the head of the firm's audit department.

SAS No.44 has created a problem for our firm and I don't think that the exposure draft has addressed our concern. The exposure draft in paragraph 10 addresses whether the user auditor should request a report from the service auditor. Paragraph 12 states that under certain circumstances the service auditor's report should include not only the policies and procedures placed in operation at the service organization but also tests of the operating effectiveness of the policies and procedures.

Our problem is a practical one. We ask for the service auditor's report and we do not receive a response. The failure to respond is caused by personnel in the service organization who are not aware of the existence of such a report or the failure of the service organization to recognize the need to obtain a report from their auditors.

Once we discover that we are not going to obtain a service auditors report it is often late in the field work period. We often make one last attempt to obtain the report by having our client demand the report from the service organization. If that doesn't work our only alternative, under both SAS No.44 and the exposure draft, is an audit of the policies and procedures of the service organization. The audit may be a \$2,000 audit of a small retirement plan. To properly audit the policies and procedures of the trust department of a major bank that is the trustee of the retirement plan would cost thousands of dollars. No client is receptive to a last minute change dramatically increasing the audit fee. I cannot believe that we are the only CPA firm in the country with this problem. I wrote to AICPA technical citing examples of incorrect responses to SAS No.44 letter and got a technical answer from a technical person who had never practiced public accounting. I then wrote to the Auditing Standards Board and got no response. I had hoped that the exposure draft would address the problem, but it has not.

Certified Public Accountants
2275 Research Boulevard
Rockville, Maryland 20850
301/840-2288
Fax: 301/840-2059

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Certified Public Accountants*

*Victor E. Barron
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Patrice J. McGinn
Nancy A. Toups
Mary H. Finger
David F. Dorsey
William J. Caldwell*

25A



Ms. Judith Sherinsky, Technical Manager
Auditing Standard Division, File 4315
May 23, 1991
Page Two

If the new SAS is to be affective a major educational effort has to be directed to service organizations and their auditors. Without such an effort the problem will continue and accountants will have to devise imaginative methods of documentation to show technical compliance with the standard rather than properly addressing the concerns set forth in the document.

Very truly yours,

A handwritten signature in cursive script that reads 'Lawrence R. Beebe'.

Lawrence R. Beebe

LRB:jal

Certified Public Accountants

767 Fifth Avenue
New York, NY 10153

Telephone 212 909 5000

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May 22, 1991

Judith Sherinsky, Technical Manager
Auditing Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: File 4315
Proposed Statement on Auditing Standards
Reports on the Processing of Transactions by Service Organizations

Dear Ms. Sherinsky:

KPMG Peat Marwick agrees with the guidance contained in the Auditing Standard Board's proposed statement on auditing standards, *Reports on the Processing of Transactions by Service Organizations*. Presented for your consideration are our comments on the exposure draft. We have organized our comments according to those which we believe will substantially improve the guidance contained in the standard, and those which are more editorial in nature.

TESTS OF CONTROLS

Paragraph 27 describes procedures performed to determine whether policies and procedures are placed in operation. These procedures are the same or similar to tests of controls described in paragraph 35 of SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit* (SAS 55). Paragraph 41 (and on) does not purport to describe tests of controls. Accordingly, we are left wondering what procedures in addition to those described in paragraph 27 would constitute tests of controls. The implication is either that the extent of procedures is the determining factor, or reperformance must be conducted. Both of these implications are inconsistent with SAS 55. The guidance should be clarified by describing tests of controls, and forthrightly stating that some procedures to determine whether policies and procedures are placed in operation are also tests of controls.

RESPONSIBILITY OF MANAGEMENT OF THE SERVICE ORGANIZATION

The overall tone of the exposure draft does not adequately distinguish the responsibilities of the service auditor and those of the service organization. The service auditor is responsible for his or her report and the application of audit procedures, and the service center management is responsible for the completeness and accuracy of the description of the system and control procedures, including any changes occurring since the last service auditor's report, and the appropriateness of the stated control objectives. We are concerned

that the tone of this statement creates an expectation that the service auditor will assume responsibility for all of the preceding information.

For example, paragraphs 28 and 43 fail to mention management's responsibility to report changes in their system or procedures and inform the service auditor about them. Paragraphs 33 and 48 state that the service organization may prepare the description. Better guidance for those paragraphs is as follows: "The representations in the description of the policies and procedures and the stated control objectives are the responsibility of the service organization's management. If the service auditor prepares the description, he or she should obtain management's concurrence with each aspect of the description." This is similar to guidance about representation letters contained in the AICPA Audit and Accounting Guide "Audits of Service-Center-Produced Records."

In paragraph 57, written representation from service organization management should also be received with respect to the completeness and accuracy of the description of the policies and procedures and the stated control objectives as currently suggested by the AICPA Audit and Accounting Guide "Audits of Service-Center-Produced Records."

EVIDENTIAL MATTER

We believe that there are methods, other than those described in the exposure draft, for the user auditor to obtain evidential matter with respect to whether control policies and procedures have been placed in operation, and whether they are operating effectively.

For example, paragraphs 10, 14 and 20 describe situations in which a user auditor would consider alternative methods of obtaining an understanding of a service organization's control policies and procedures that may be relevant to the user entity. The alternatives described include obtaining a service auditor's report, performing procedures at the service organization, or having the service auditor perform agreed-upon procedures. If the service organization employs internal auditors, they should also be considered as an alternative method of obtaining an understanding as described in paragraph 13 of SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (SAS 65). Guidance in SAS 65 should also be followed with respect to assessing the competence and objectivity of the internal auditors.

MINIMUM PERIOD COVERED BY A REPORT INCLUDING TESTS OF CONTROLS

Paragraph 44f. introduces the minimum period to be covered by the service auditor's report, six months. The logic behind why six months was selected as the minimum period should be presented, as it does not appear to be consistent with SAS 55, paragraph 46. We are also concerned that without such logical support the minimum period may be interpreted as being the standard period; that is, service auditors may be inclined to cover only six months as opposed to a full year as a result of the lack of guidance in the exposure draft.

If the six month minimum reporting period is supported and retained, there should be more explicit guidance as to how this would be applied, as well as information about factors the auditor should consider in determining the period to be covered. For example, one auditor might test controls at a detailed level at a point in time, then evaluate EDP general controls

for the balance of the period. Another auditor might understand the exposure draft to require transaction testing throughout the period. The SAS should provide guidance to link the report to a detailed description of the nature, timing and extent of tests of controls performed throughout the period covered by the report.

Finally, guidance should be given as to the proper dating of the report.

EDITORIAL COMMENTS

We believe the following comments would improve the clarity of the guidance contained in the exposure draft:

In paragraph 23, the service auditor is not only reporting to user auditors, but also to management and other specified parties.

Paragraph 25 should be expanded similar to paragraph 23 of SAS 55 to include a statement that information would also be obtained from previous experience with the entity and observation of entity activities and operations.

Paragraph 29e. should parallel the illustrative report by stating: "The service auditor's opinion on whether the description presents fairly, in all material respects, the relevant aspects"

The second sentence of paragraph 43 should refer to 'the user auditors' audits', rather than 'the user auditors' examinations'.

Paragraphs 29f. and 44h. refer to the " . . . the risk of projecting any evaluation of the description to future periods." The service auditor's report does not refer to this risk, nor does it include an evaluation of the description. The statements will be accurate if the words "any evaluation of" are dropped from these paragraphs.

We would be pleased to discuss any questions which you may have regarding our comments.

Very truly yours,


KPMG PEAT MARWICK



MassMutual

May 28, 1991

BY FAX

Ms. Judith Sherinsky
Technical Manager, Auditing Standards Division
File 4315
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, N.Y. 10036-8775

Re: Exposure Draft of Proposed Statement on Auditing Standards Titled *Reports on the Processing of Transactions by Service Organizations.*

Dear Ms. Sherinsky:

Massachusetts Mutual Life Insurance Company ("MassMutual") appreciates both the opportunity to comment on the Auditing Standards Board's proposed statement on auditing standards titled *Reports on the Processing of Transactions by Service Organizations* and the Board's willingness to receive these comments after passage of the May 27 deadline. MassMutual only learned of the proposed statement on auditing standards recently and apologizes for any inconvenience resulting from our late filing. MassMutual is located in Springfield, Massachusetts and is a major financial institution with over \$27 billion in assets. It is the twelfth largest life insurance company, and one of the top fifty pension plan managers, in the United States. MassMutual is also one of a handful of life insurance companies with the top rating from the independent rating firms.

MassMutual has carefully considered the proposed statement on auditing standards. Although MassMutual supports, as a policy matter, the single scope audit approach for audits of employee benefit plans that use the services of an insurance company for the investment of employee benefit plan assets, we would like to express our concern that the benefits expected to be derived from these audits do not justify the anticipated cost. Since much of the cost incurred by service organizations as a result of the single scope audit will be passed on to employee benefit plan sponsors and participants, it is in the interest of all parties involved in this procedure to mitigate costs to the greatest extent possible, consistent with the accounting industry's professional responsibility to provide complete and accurate audits.

Cost Concerns. Discussions with MassMutual's independent auditor and a member of the

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Ms. Judith Sherinsky
May 28, 1991
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accounting firm retained by the American Council of Life Insurance as a consultant on the proposed statement on auditing standards have led MassMutual to anticipate that the cost for this audit procedure will likely exceed \$50,000.00 annually. We have been told that this is only a rough estimate and, as a result of the company-wide impact of the single scope audit requirement, we have reason to believe it very well may be optimistic.

In attempting to understand the reasons for the costs associated with the single scope audit approach, MassMutual has been informed that the information that will have to be collected, tested and analyzed to satisfy the requirements imposed by the proposed statement on auditing standards is far greater than that which is currently required. However, if accountants are presently able to provide an opinion, in accordance with generally accepted accounting procedures, on employee benefit plan's financial statements and supplemental schedules based on the information currently required, we question the need for the additional information and the increased scope of testing that would be required by the proposed statement on auditing standards. Accordingly, MassMutual requests that the Accounting Standards Board carefully consider the necessity of the increased scope of testing and the extensive reporting on the description of the relevant control structure required by the proposed statement on auditing standards.

The proposed statement on auditing standards does not provide guidance as to how frequently the service organization must be audited to permit the user auditor to rely on the service auditor's report. MassMutual infers from ERISA's annual reporting requirement that the audit of the service organization would have to be performed annually. We believe that annual audits of a service organization may be more frequent, and, therefore, result in greater expenditure of financial and personnel resources, than is necessary. The costs associated with the single scope audit could be controlled by permitting a user auditor to rely on a triennial audit of a service organization instead of requiring annual audits. During years in which a service organization is not required to perform a comprehensive audit, we believe that an interim report of any material changes in the service organization's control structure would provide a sufficient basis for a user auditor to issue an opinion on the user organization's employee benefit plans. Therefore, MassMutual would request that the Board consider revising the final statement on audit standards either to specifically permit reliance on triennially performed audits (with annual updates) or, in the alternative, to indicate that a user auditor's reliance on triennial audits would constitute compliance with accepted accounting procedures.

The proposed statement of audit standards provides that a user auditor may visit a service organization and perform procedures to obtain whatever information the user auditor deems necessary to obtain a sufficient understanding to plan the audit (paragraph 10), to assess control risk (paragraphs 12 and 14) and to determine the sufficiency of the service auditor's report (paragraph 20). At the time the single scope audit approach was originally proposed, it was MassMutual's understanding that once a service organization incurred the expense (both financial and in terms of personnel resources) for the performance of such an audit

Ms. Judith Sherinsky
May 29, 1991
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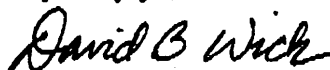
and provided the resulting audit report to user organizations, it would be insulated from the expense and loss of time involved in responding to further inquiries from user auditors. As drafted, however, the proposed statement of auditing standards provides no such protection and MassMutual is very concerned that, from a service organization's perspective, this appears to eliminate one of the principal advantages of the single scope audit. Accordingly, MassMutual believes the statement on auditing standards should explicitly state that a user auditor can generally rely upon the audit report provided by the service auditor and that the user auditor is not required to seek additional information from, or perform additional tests at, the service organization unless material unanswered questions remain after a review of the audit report of the service organization, information available from the user organization and information otherwise provided by the service organization.

Fiduciary Status. The Appendix is designed to provide guidance on the application of the statement on auditing standards to fiduciaries of employee benefit plans subject to the requirements of ERISA. The provisions of the Appendix appear to imply that all service organizations that provide services to employee benefit plans are considered fiduciaries under ERISA. Since not all service organizations constitute fiduciaries, as defined in ERISA §3(21)(A), MassMutual would recommend that the final statement on auditing standards be revised to refer to service organizations that provide services to, or manage the assets of, employee benefit plans subject to the requirements of ERISA.

Legal Compliance. Finally, paragraphs 56 and 58 of the exposure draft indicate that the service auditor may be requested to perform tests of compliance with laws and regulations affecting the processing of user transactions. Similarly, paragraph 6 of the Appendix indicates that the service auditor is required to report on the compliance with ERISA requirements by fiduciaries and plans. MassMutual does not believe that these are areas in which accountants should be required to make such judgments and should properly be made by attorneys representing the fiduciaries and plans.

MassMutual would be willing to provide further comments as the Auditing Standards Board continues its consideration of the statement.

Very truly yours,



David B. Wick
Counsel

cc: Mr. James Wertheimer B407
Mr. William Fetherston K259
Mr. Kenneth Cohen K379



NEW HAMPSHIRE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS
3 EXECUTIVE PARK DRIVE • BEDFORD, NEW HAMPSHIRE 03102-2137
TEL. (603) 622-1999 • FAX (603) 626-0204

May 24, 1991

Judith Sherinsky
Technical Manager
Auditing Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036

File Reference No. 4315

Dear Ms. Sherinsky:

The Audit & Accounting Committee of the New Hampshire Society of CPA's has reviewed your proposed statement on auditing standards "Reports on the Processing of Transactions by Service Organizations." On behalf of the Committee, I am respectfully submitting a comment on the exposure draft:

Overall

We support your efforts to require standardized reporting between the service auditor and the user auditor. We believe that this will eliminate a great deal of confusion in the reading and understanding of these reports.

The above comment is the opinion of the Audit & Accounting Committee of the New Hampshire Society of CPA's and does not necessarily reflect the views of the Society as a whole, nor of its Board of Directors nor of the individual members of the Board.

Should you have any questions concerning the above, please contact Brant Hardy, CPA at 508-632-3050.

Yours truly,

Brant Hardy, CPA
Chairman, Audit & Accounting
Committee
New Hampshire Society of CPA's

File Ref. No. 1120
4315

June 11, 1991

To the Auditing Standards Board:

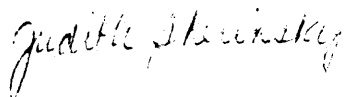
Here are copies of additional comment letters I have received about the exposure draft of the proposed statement on auditing standards, Reports on the Processing of Transactions by Service Organizations. Comment letters 1 through 28 were sent to you in previous mailings.

	<u>Name/Affiliation</u>	<u>Location</u>
29.	Timothy E. Durbin Arthur Andersen & Co.	Chicago, IL
30.	Jon H. Flair Heard, McElroy & Vestal	Shreveport, LA
31.	William J. Sharkey Defense Contract Audit Agency	Alexandria, VA
32.	Hugh J. Posner Society of Louisiana CPAs	Kenner, LA
33.	Price Waterhouse	New York, NY
34.	Walter M. Primoff New York State Society of CPAs	New York, NY
35.	Ernst & Young	Cleveland, OH
36.	Robert W. Granow Aetna	Hartford, CT
37.	Coopers & Lybrand	New York, NY
38.	Douglas L. Blensly California Society of CPAs	Glendale, CA

39. John Kiss
Illinois CPA Society and
Foundation

Chicago, Il

Sincerely,



Judith Sherinsky
Technical Manager
Auditing Standards Division

JS:lb
Enclosures

cc: Service-Center-Produced Records Task Force

ARTHUR ANDERSEN & Co.

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602
(312) 580-0069

May 28, 1991

Ms. Judith M. Sherinsky
Technical Manager
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: File 4315

Dear Judith:

Enclosed is our Firm's comment letter on the proposed Statement on Auditing Standards, "Reports on the Processing of Transactions by Service Organizations."

Very truly yours,

Timothy E. Durbin

MT/7662w

Enclosure

29a

ARTHUR ANDERSEN & CO.

69 WEST WASHINGTON STREET
CHICAGO, ILLINOIS 60602
(312) 580-0069

May 28, 1991

Ms. Judith M. Sherinsky
Technical Manager
Auditing Standards Division
American Institute of
Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: File 4315

Dear Ms. Sherinsky:

This letter is in response to the request for comments on the proposed Statement on Auditing Standards (SAS) entitled, "Reports on the Processing of Transactions by Service Organizations."

PRINCIPAL COMMENTS

Generally, we support the thrust of the exposure draft--to provide expanded guidance to user auditors in considering the impact of a service organization in planning and conducting an audit of an entity that utilizes the services of such an organization. We believe such expanded guidance is necessary for several reasons. First, out-sourcing of administrative-type functions has increased dramatically in recent years and is expected to continue. Thus, third-party processing of another entity's transactions will be an increasingly important aspect of many entities' internal control systems. Furthermore, the recent emphasis on internal control both within and without the profession (including regulators) is yet another factor contributing to the need for expanded and clear guidance in this area. Finally, there is some concern that user auditors may be placing undue reliance upon a service auditor's report on design only in restricting the nature, timing and extent of substantive audit procedures. We believe the clarification provided in this proposed SAS is responsive to that concern.

We do, however, have a number of suggestions that, if incorporated in the final pronouncement, should improve the understandability of the SAS for those that must apply it in practice. For ease of reference, our comments and suggestions are presented under the following headings consistent with the organization of the exposure draft:

- o The user auditor's consideration of the effect of the service organization on the user's internal control structure.

- o Using a service auditor's report.
- o Responsibilities of service auditors.
- o Appendix demonstrating the applicability of the guidance to employee benefit plan audits.

USER AUDITOR'S CONSIDERATION
OF A SERVICE ORGANIZATION

Paragraph 6 distinguishes between (a) those services limited to recording user transactions and processing the related data with the user organization retaining responsibility for authorizing transactions and maintaining related accountability and (b) those services in which the service organization initiates and executes transactions on behalf of the user organization and maintains the related accountability. The point of making a distinction is that in the former situation, there can be a high degree of interaction between the controls at the service organization and those at the user organization and, therefore, it is possible for the user organization to implement appropriate controls over those transactions. In contrast, in the latter situation, there is a lower degree of interaction and, consequently, it may not be practical for the user organization to implement effective controls over the transactions executed by the service organization.

We suggest that the guidance in paragraph 6 be expanded to state explicitly how the degree of interaction affects the auditor's responsibility to obtain an understanding of the internal controls at the service organization. The implication seems to be that when there is a high degree of interaction, the user auditor may be justified in ignoring the controls at the service organization, but when there is a low degree of interaction, the user auditor should address the controls at the service organization. However, as noted below, a high degree of interaction may not relieve the auditor of his responsibility to understand the controls at a service organization when the other factors (the nature and materiality of the transactions processed by the service organization) are taken into consideration.

Paragraph 6 also notes, almost as an afterthought, that the nature and materiality of the transactions, along with the degree of interaction, are the most important factors in assessing the significance of the service organization's controls on the user's internal control structure. We believe more emphasis should be given to the nature and materiality factors in assessing significance. We are aware of situations in which a service organization may process virtually all of a user organization's transactions, some of which may be of a very complex nature. In these circumstances, while there still can be a high degree of interaction and user controls over those transactions, it may not be appropriate for the user auditor to ignore the controls at the service organization.

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Paragraph 8 lists ten factors that the user auditor should consider in determining the significance of the service organization's policies and procedures to planning the audit. First, more emphasis should be given in this listing to the three most important factors cited in paragraph 6. Secondly, under the third item, we do not believe that whether the services are highly standardized or unique should be a factor in assessing significance. Finally, we question the relevancy of the seventh factor listed (the service organization's capability and capacity) in determining how significant a service organization's policies and procedures are to audit planning.

Paragraph 12 states in part that a service auditor's report on policies and procedures placed in operation typically does not provide evidence of operating effectiveness to allow the user auditor to reduce the assessed level of control risk. Consistent with that comment, paragraph 24a states that such reports generally do not provide the user auditor with a basis for reducing his or her assessments of control risk.

The use of the words "typically" and "generally" imply there are situations in which these reports would provide evidence of operating effectiveness. However, paragraph 14 states rather clearly that if the user auditor plans to assess control risk below the maximum for policies and procedures applied only at the service organization, he or she should evaluate the operating effectiveness of those policies and procedures by (a) obtaining either a report on operating effectiveness or an agreed-upon procedures report from the service auditor, or (b) performing tests of controls at the service organization. In addition, paragraphs 37 and 52 indicate that a service auditor's opinion on design is not intended to provide evidence of operating effectiveness. Accordingly, we suggest that either (a) the words "typically" and "generally" be deleted from paragraphs 12 and 24a respectively or (b) appropriate guidance be included that describes circumstances in which reports on policies and procedures placed in operation provide evidence of operating effectiveness.

Under the section, "Responsibilities of Service Auditors," paragraph 40 describes a service auditor's report that excludes an opinion on suitability of design. However, nowhere in the first section of this proposed SAS is there any comparison of this type of report to a report that includes such an opinion, and the impact of those different reports on planning the audit of the user organization. Guidance should be provided on this issue since it is the needs of the user auditors that in the final analysis impact the type of report the service auditor will be requested to render.

CONSIDERATIONS IN USING A SERVICE AUDITOR'S REPORT

Paragraph 20 calls for the user auditor to consider the guidance in AU Section 543.12 in assessing whether the service auditor's report is sufficient. We

Ms. Judith M. Sherinsky

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May 28, 1991

believe that the service auditor can make that assessment solely by reading the service auditor's report and that the procedures set forth in paragraph 12 of AU Section 543 become a consideration only when the user auditor concludes that the service auditor's report is not sufficient for his or her purposes. In fact, the reference to AU 543.12 is redundant with the suggestions set forth in paragraph 20 when the user auditor concludes that the service auditor's report may not be sufficient. Consequently, we suggest that the reference to AU Section 543.12 be deleted.

RESPONSIBILITIES OF SERVICE AUDITORS

Paragraphs 32 and 47 call for the service auditor to consider and report, irrespective of stated control objectives, whether information has come to his or her attention that causes the service auditor to conclude there are design deficiencies and for which it is not expected that user organizations would have policies and procedures in place to mitigate such deficiencies. We believe the service auditor should report design deficiencies unrelated to the stated control objectives on the same basis that he or she would report design deficiencies related to stated control objectives--that being without considering whether user organizations might have procedures in place to mitigate those deficiencies. In our view, it is inappropriate and unrealistic to impose upon the service auditor an obligation to assess the presence or absence of user organization controls when no such obligation is imposed in any other circumstances involving the reporting of service organization control deficiencies.

Opinion on operating effectiveness. A report on policies and procedures placed in operation and operating effectiveness normally contains an opinion as to whether the service organization's relevant policies and procedures are suitably designed to achieved specified control objectives. However, although the service auditor performs tests of these policies and procedures, the report only acknowledges the performance of those tests and directs the user auditor to information that sets forth the specific policies and procedures tested, the nature, timing and extent of the tests performed and the results of those tests.

We fail to understand the logic behind permitting a service auditor to render an opinion on design but not on operating effectiveness. Furthermore, the third paragraph in the sample report in paragraph 38 clearly implies that had the service auditor performed procedures to assess operating effectiveness, he or she would have expressed such an opinion.

We believe that the service auditor should express an opinion, based on the results of his or her tests of controls, as to whether the internal control structure policies and procedures at the service organization were operating effectively during the period tested. To impose upon the individual user auditors the obligation to make that determination is both unfair and

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unnecessary. It is the service auditor who is in the best position to assess the results of those tests insofar as they apply to achievement of specified control objectives at the service organization and that assessment would not negate the need for user auditors to separately assess control risk at the individual user organizations.

APPENDIX

One of the more significant changes to the prior guidance (SAS 44) is the deletion of the report expressing an opinion on the system of internal accounting control of a segment of a service organization in the classification "service auditors' reports." We agree that such a report does not belong in the guidance on service auditors' reports.

However, we have certain concerns with respect to the guidance presented in this appendix. First, although paragraph 2 cites three factors to be considered (in addition to those mentioned in paragraph 8 of the Statement) in determining whether a plan auditor needs specific information about the control structure of a fiduciary, it provides no guidance as to those situations in which such information ordinarily would be necessary.

Secondly, the sample "Table of Contents" in paragraph 6 implies that a report expressing an opinion on a fiduciary's system of internal accounting control (an SAS 30 report) is not an acceptable alternative. Given current practice, we believe an SAS 30 opinion-type report may very well meet the needs of auditors of employee benefit plans with assets trusted under a discretionary trust arrangement.

Third, we have some concern as to the utility of all detailed information that would be provided by service auditors following the guidance in this appendix. Finally, although this appendix is directed at employee benefit plans subject to ERISA, much of this guidance would apply to employee benefit plans exempt from ERISA.

For these as well as other reasons, we recommend that the appendix be deleted from the final SAS and the appropriate guidance for considering the internal control structure of a fiduciary under a discretionary (or nondiscretionary) trust arrangement with respect to audits of employee benefit plans be set forth in an amendment (Statement of Position) to the forthcoming pension audit guide.

OTHER COMMENTS

Paragraph 3 sets forth the applicability of the SAS. It states, in part, that the provisions of the statement are not intended to apply to situations in which the services provided are limited to execution of 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

Ms. Judith M. Sherinsky

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May 28, 1991

securities transactions by a broker, nor is the statement intended to apply to the audit of transactions arising from financial interest in partnerships, corporations and joint ventures, although the auditor of the holder of such an interest may find the guidance in this statement useful.

In order to clarify the applicability of this pronouncement, we suggest that the fourth sentence in paragraph 3, "The provisions of this statement...are limited to execution of client organization transactions that are specifically authorized..." be revised to include the phrase "and individually" after the word "specifically" to make it clear that authorizing the processing of a group or class of transactions would not fall under the exemption. In addition, we suggest that the last sentence in paragraph 3 be deleted because we do not believe that the internal controls in a partnership, corporation or joint venture are part of the internal control structure of a holder of a financial interest in such entities. In fact, we have some concern that this sentence might be misinterpreted as permitting a service auditor's report to serve as a substitute for audit work that would otherwise be performed on the financial statements of these entities.

In order to facilitate a better understanding of the guidance in this standard, we suggest that the final pronouncement, similar to SAS 55 and recently released SAS 65, contain flowcharts summarizing the various sections.

We suggest that the reports on policies and procedures placed in operation and reports on policies and procedures placed in operation and tests of operating effectiveness be expanded to include a statement that the policies and procedures of the service organization and the stated control objectives are the responsibility of management of the service organization.

Paragraph 44f and paragraph 53 state that when performing tests of controls, at a minimum, the tests should cover a six-month period. We suggest that supporting rationale for the minimum six-month period be presented in the final pronouncement so that unwarranted inferences will not be drawn from this guidance that tests of controls of any entity's internal control structure's policies and procedures should cover, at a minimum, a six-month period. It is our understanding that SAS 55 and the related audit guide do not impose any minimum period when performing tests of controls.

The headings above paragraphs 34 and 49 should be deleted since they imply that there is a separate report for reporting on design when in fact that is not the case. On the other hand, a separate heading above paragraph 40, which describes the modifications to the report on policies and procedures placed in operation when an opinion on design is not included, would be appropriate.

Finally, we believe the readability of the final pronouncement would be improved if the redundancy contained in the guidance under "Reports on policies and procedures placed in operation" and "Reports on policies and procedures and tests of operating effectiveness" were removed. This could be

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ARTHUR ANDERSEN & CO.

Ms. Judith M. Sherinsky

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May 28, 1991

accomplished by simply citing under the latter section, the additional information and work required by the service auditor in order to report on operating effectiveness.

We would be happy to discuss our comments and suggestions in more detail at your convenience.

Very truly yours,

MT/7619w

Arthur Andersen & Co.

29h

EXPOSURE DRAFT

FILE 4315

PROPOSED STATEMENT ON AUDITING STANDARDS

REPORTS ON THE PROCESSING OF TRANSACTIONS BY SERVICE ORGANIZATIONS

February 27, 1991

Comment date: May 27, 1991

Name and Affiliation: JON H. FLAIR P. O. Box 1607
HEARD, MC ELROY & VESTAL SHREVEPORT, LA 71165

Comments: PARAGRAPH 14 OF THE EXPOSURE DRAFT STATES
THAT THE <USER> AUDITOR SHOULD OBTAIN A REPORT OF
ANOTHER INDEPENDENT AUDITOR THAT DESCRIBES THE RESULTS
OF THE OTHER AUDITOR'S TESTS OF POLICIES AND PROCEDURE
PLACED IN OPERATION AND TESTS OF OPERATING EFFECTIVENESS
OR AN AGREED-UPON PROCEDURES REPORT... " PARAGRAPH
44 THEN GOES ON TO DESCRIBE THE ELEMENTS OF "REPORT
ON POLICIES AND PROCEDURES PLACED IN OPERATION AND
TESTS OF OPERATING EFFECTIVENESS "

COMMENT

THE ABOVE WORDING ALLOWS THE AUDITOR A CHOICE
OF REPORTS TO ISSUE, AN AGREED-UPON PROC'S
REPORT (UNDER AU § 622 AND/OR AU § 642.60) OR
A REPORT DEFINED UNDER THE PROVISIONS OF THIS
EXPOSURE DRAFT REGARDING TESTS OF OPERATING
EFFECTIVENESS. HOWEVER, THE EXPOSURE DRAFT RE
QUIREMENTS ARE MUCH MORE SPECIFIC THAN IN
AU §§ 622 AND 642, AT LEAST IN THE FOLLOWING
AREAS:

Instructions for Response Form

This response form may be used for comments or suggestions relating to any aspect of the exposure draft that is of concern or interest to you. For convenience, the most significant points have been identified in the summary that accompanies this exposure draft.

Return this response form to the address indicated on the reverse side by the comment date.

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Comments (continued):

A. THE SIX-MONTH COVERAGE PERIOD SPECIFIED
IN PARAGRAPH 44 F. OF THE EXPOSURE DRAFT.

B. THE STATEMENT REQUIRED IN PARAGRAPH 44E
THAT THE AUDITOR BELIEVES THE TESTS OF
CONTROLS WERE APPROPRIATE...

BECAUSE OF THE INCONSISTENCIES THAT COULD
ARISE IN ISSUING REPORTS UNDER THESE VARIOUS
STANDARDS, I SUGGEST THAT REPORTS REFERRING
TO TESTS OF OPERATING EFFECTIVENESS AND PROCEDURES
PLACED IN OPERATION, AS THEY PERTAIN TO SERVICE
ORGANIZATIONS, BE PREPARED STRICTLY IN ACCORDANCE
WITH THE REQUIREMENTS CONTAINED IN THE
PROPOSED STATEMENT.

Return responses to:

AICPA

Judith Sherinsky, Tech. Mgr.
Auditing Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775



IN REPLY REFER TO

DEFENSE CONTRACT AUDIT AGENCY
CAMERON STATION
ALEXANDRIA, VA 22304-6178



28 MAY 1991

PFD 1-101

Ms. Judith Sherinsky
American Institute of Certified Public
Accountants
Auditing Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

We have reviewed the EXPOSURE DRAFT of the proposed statement on auditing standards for Reports on the Processing of Transactions by Service Organizations, dated 27 February 1991, FILE 4315. Based upon our review, we offer the following recommendation for clarifying the proposed standard.


The responsibilities of user auditors for planning the audit of user organizations are covered in paragraphs 7 through 10, and are well defined. Paragraph 11 states that the user auditor may conclude that it may be most efficient for the user auditor to obtain evidential matter regarding the operating effectiveness of the service organizations policies and procedures to provide a basis for the user auditor's assessment of control risk below the maximum. However, the proposed standard is silent regarding a requirement for the service auditor to furnish the user auditor with the requested information. We believe the proposed standard should contain wording similar to that contained in Paragraph .20 of SAS No. 44 which states:

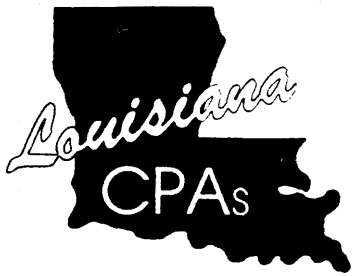
The user auditor should contact the service organization through the client organization to determine whether a service auditor's report on the service organization's internal accounting controls is available and, if so, the type of report that is available.

The proposed standard should include administrative procedures, as presently provided in SAS No. 44, for obtaining the service auditors' reports or services.

Should you have any questions regarding our recommendation, I may be contacted at (703) 274-7323.

Sincerely,


William J. Sharkey
Assistant Director
Policy and Plans



May 28, 1991

Ms. Judith Sherinsky, Technical Manager
Accounting Standards Division, File 4315
AICPA, 1211 Avenue of the Americas
New York, NY 10036-8775

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Executive Director
Barry C. Melancon

Dear Ms. Sherinsky:

The Society of Louisiana Certified Public Accountants appreciates the opportunity to comment on the exposure draft entitled Proposed Statement on Auditing Statements -- Reports on the Processing of Transactions By Service Organizations, dated February 27, 1991.

The exposure draft was acceptable to all those committee members who responded, except for one. The following is his response verbatim.

"The exposure draft is well conceived with the exception of the appendix. The appendix addresses the need for specific information about the control structure of a fiduciary by and auditor of a benefit plan subject to ERISA.

In our opinion the appendix falls short of providing the "user-auditor" with the appropriate beneficial information when a fiduciary has authority to execute transactions without the specific involvement of the plan administrator. Considering the volume of text that was devoted to service organizations that generally do not have access to assets being reported on by user-auditors I would think that more relevant discussion would have ensued in the appendix.

An alternate to the appendix would be to interject the application to apply to fiduciaries and, where appropriate, expand the language within the basic exposure draft."

**Society of Louisiana
Certified Public Accountants**
2400 Veterans Blvd., Suite 500
Kenner, LA 70062-4739
(504) 464-1040
(800) 288-5272
(504) 469-7930 (Fax)

Ms. Judith Sherinsky
May 28, 1991
Page 2

If you have any questions, please do not hesitate to call.

Yours very truly,

Hugh J. Posner, ebc

HUGH J. POSNER, CHAIRMAN
ACCOUNTING PRINCIPLES AND
AUDITING PROCEDURES COMMITTEE

HJP/ebc

cc: Edward Conway

Price Waterhouse



May 31, 1991

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division
File 4315
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

Reports on the Processing of Transactions
by Service Organizations

We appreciate the opportunity to comment on this proposed Statement on Auditing Standards. Our comments include proposals for major changes to the exposure draft and other comments for consideration during the remaining deliberations leading to a new SAS.

Employee Benefit Plans

The proposed SAS would provide guidance for auditors of employee benefit plans that use service organizations, such as bank trust departments and EDP service centers. However, the proposed revisions to the prescribed service auditor reports would provide each user auditor with an abundance of data to read, analyze and assess, but less, rather than more, assurance about the internal control structure of the service organization than is provided under the existing SAS 44.

Further, the exposure draft is generic; it is written to apply to a wide variety of service organizations and user organizations. We believe that issues affecting coordination of the work performed by service auditors and by user auditors regarding audits of employee benefit plans are sufficiently important to warrant being addressed separately and specifically. In addition to service organization processing of transactions such as benefit payments,

they include issues related to the reliability of records of assets held by bank trust departments and other financial institutions, investment transactions and income received on the invested assets.

In addressing auditor coordination issues related to employee benefit plans, a goal should be to develop the smoothest possible seam so that the service auditor performs the work at the service organization and provides the user auditor with a report conducive to the user auditor being able to perform an effective audit efficiently without having to make further inquiries of either the service auditor or the service organization and without having to perform additional work at the service organization. In this regard we note that the Deputy Secretary of Labor, in his March 20, 1990 letter to Congress proposed:

"...that ERISA be amended to repeal the limited scope exemption and that a provision which enables plans and financial institutions to utilize a "single audit" approach be enacted."

Other relevant paragraphs from his letter are attached.

We believe that the ASB rather than government officials should develop the standards that would apply in these circumstances. We are concerned, however, that the proposed SAS will not minimize aggregate employee benefit plan audit costs and, consequently, will not meet the expectations of DOL and of Congress.

Consequently, we recommend that employee benefit plans be explicitly excluded from the proposed SAS and be designated a topic for which additional work and another approach is needed. The need for another approach will be especially important if Congress repeals the limited scope exemption in anticipation that the additional auditing costs would be minimized by professional auditing standards that embrace a single audit concept.

Reports Encompassing Tests of Effectiveness

In addition to excluding employee benefit plans from the scope of the draft, we recommend that the ASB reconsider the proposals for reporting on tests of effectiveness. The exposure draft substantially reduces the benefit to a user auditor of a service

auditor's report that encompasses tests of operating effectiveness as compared to that obtained from a service auditor's report under SAS 44.

The report under SAS 44 requires a sufficient scope of work to enable the service auditor to report whether "the degree of compliance with (the described control procedures) was sufficient to provide reasonable, but not absolute, assurance that the control objectives were achieved." If the proposal becomes a SAS, user auditors would be required to read and assess the details of the service auditor's tests of effectiveness. Also we expect that user auditors will more often be put in a position of either performing their own tests of effectiveness at the service organization or having to resort to a less efficient audit plan than would otherwise be necessary. Further, the language in the proposed service auditor's report, "...we applied tests...to obtain evidence of effectiveness...We believe our tests were appropriate in the circumstances....This information has been provided...(for use) when making assessments of control risk for user organizations," may make it more difficult for the user auditor to convince both the user organization and the service organization that additional tests of effectiveness are necessary.

Accordingly, we recommend that the exposure draft be revised to reinstate a scope of work that will enable a service auditor to express an opinion on operating effectiveness. In the absence of that requirement, a revision should require the service auditor to perform sufficient tests to express negative assurance as to the operating effectiveness of the described control policies and procedures that in his or her judgment would have the greatest effect on user auditors' assessments of control risk. If the proposed scope of work that the service organization would accept would not be sufficient for the service auditor to express at least negative assurance, the engagement should not be accepted by the service auditor.

Further, unless the service auditor expresses an opinion as a result of his or her tests of effectiveness, the illustrated report paragraph describing the tests of effectiveness should end after the first reference to Schedule X and the word "certain" should be inserted before "tests" in the remaining sentence. The words that would be deleted

provide no useful information to the user auditor and may mislead user organization management.

Reports on the System of a Segment
of the Service Organization

We believe that user organizations, service organizations and auditors have found the reports provided for in the present SAS 44/AU 324.42 through .46 useful in a number of circumstances. We also believe that the focus of those reports on the service organization's objectives for the system, together with the service auditor's conclusions as to whether the system was sufficient to meet the objectives, provide user auditors with the essential information they need and want to obtain. Accordingly we believe that explicit provision for those reports should be added to the proposal or otherwise retained in the body of Statements on Auditing Standards.

Other Comments

Paragraph

- 3 The last sentence, a vague comment that auditors may find this proposed SAS useful in circumstances to which it does not apply, should be deleted.
- 27 We do not see reason for prescribing procedures the service auditor should perform to determine whether the service organization's policies and procedures are placed in operation that differ from the guidance that applies to an audit. Further, prescribing the "tracing of a limited number of transactions by..." may lead some auditors to assess control risk at less than maximum based on comparing these words to SAS 55/AU 319.47 and the guidance and examples in the related Audit Guide. We consider such an interpretation possible despite the guidance in the second sentence of paragraph 12 and in paragraph 37 of the proposal that a

report on procedures placed in operation typically does not allow the user auditor to reduce the assessed level of control risk. Consequently, we recommend that the first sentence of paragraph 27 be replaced with: "Knowledge of whether the service organization's policies and procedures have been placed in operation is ordinarily obtained from the same sources as such knowledge would be obtained in an audit (see SAS 55/AU 319.23-.24)."

39 The illustrated opinion paragraph should be changed to refer to an exception as to the suitability of design rather than to an exception as to the description of the system. This comment also applies to paragraph 55.

40 This paragraph and footnote 3 to paragraph 29 enable a service auditor to limit the scope of the engagement to exclude an opinion on the suitability of the design of the control structure. We would prefer that this option not be available. If it is retained, the SAS should include guidance for the user auditor to consider on receipt of such a report. For example, making inquiries into the reason for the limited scope engagement, making inquiries to more fully understand the effects of the policies and procedures described, and making inquiries (and possibly performing other procedures) about intangible aspects of the control structure (such as the service organization management's integrity, attitude toward control, competence) sufficient to provide the user auditor a basis for a conclusion about the suitability of the design if that conclusion would affect the user auditor's scope of work.

40 In addition, if the limited scope engagement is retained, it should be made clear that the service auditor

still has the evaluation and reporting responsibilities described in paragraph 32.

- 44f The six month minimum period for tests of effectiveness of the service organization's control policies and procedures is an edict not based on apparent logic and perhaps made without sufficient contemplation of such matters as more frequent reporting practices and the effect of changes in the service organization's policies and procedures. We believe that it should be reconsidered.
- 57 Include as an additional bullet point (say the third) in the list of management representations to obtain: "State that the report of the control structure policies and procedures describes those placed in operation and that they are suitably designed to achieve the stated control objectives."
- 58 This paragraph should be deleted. It is an apparent duplication of paragraph 56 and would require reporting on tests of compliance with laws and regulations under the provisions of SAS 35, which was not intended for these circumstances.
- 59 The effective date for service auditor reports should precede the effective date for user auditor application by at least 1 year so that the envisioned service auditor reports are available to user auditors for audit planning purposes.

Nine paragraphs of the 59 paragraph proposal are word-for-word repetition of preceding paragraphs (i.e., paragraphs 42, 43 and 45 through 51 repeat paragraphs 26, 28 and 30 through 36). Eliminating the repetition would not only reduce the length of the standard by 15%, but would save practicing auditors from having to make their own comparisons. We think these benefits are worth the slight other revisions to the exposure draft that would be required.

We would be pleased to discuss the exposure draft and our comments on it with you and to answer any questions.

Sincerely yours,

Price Waterhouse

Excerpts from March 20, 1990 Letter from Roderick A. DeArment, Deputy Secretary of Labor, to the Honorable Tom Lantos, Chairman, Subcommittee on Employment and Housing:

The proposal is, therefore, to eliminate the statutory scope limitation and substitute a provision which would permit use of the "single audit approach." Under this approach, financial institutions holding plan assets would instruct their independent auditors to prepare a special report which covers both the design of internal accounting controls and compliance tests used to determine that these are effectively implemented. This report, prepared by the institution's auditor, would contain a detailed explanation of the procedures performed by the auditors and an opinion on the financial statements provided to the plan. It would, in essence, address the reliability of the information provided to the plan on the assets held by the institution.

The plan's auditor would then review the procedures and conclusions set forth in the report to determine whether the report received from the financial institution's auditor was sufficient to meet the plan's audit objectives. The independent report in combination with the audit procedures performed at the plan would enable the plan's auditor to express an unqualified opinion on the plan's financial statements. This would fulfill the purposes of the audit requirement without imposing the additional costs of independently reviewing the financial institution's records.

The AICPA has represented to the Department that the additional effort could entail an increase of approximately 10-30% of total staff hours. This increase would translate to a corresponding increase in audit fees.

Price Waterhouse



May 31, 1991

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division
File 4315
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

Reports on the Processing of Transactions
by Service Organizations

In addition to our comment letter of May 31, 1991,
attached are some editorial suggestions regarding
the above titled exposure draft.

Sincerely yours,

Price Waterhouse

Reports on the Processing of Transactions
by Service Organizations

Editorial Suggestions for Exposure Draft

Paragraph

- 3 The bullet points in the first sentence, which purport to explain the applicability of the statement, are too general to be of use. Effectively, only the examples determine the applicability of the proposal.
- 4a Insert "effect of the functions performed by the" before service organization.
- 5 This paragraph states that a user auditor should consider the proposed guidance when the user organization uses "a service organization to process its transactions." Paragraph 3 on applicability refers to process(ing) transactions in connection with EDP service centers (included in the scope of the statement) and "the processing of checking account transactions" (excluded).
- 6 The degree of interaction is also affected by how the service organization and user organization work with each other (e.g., the content and degree of communication between the two), which should be recognized in this paragraph.
- 13 In the first sentence, change "the user organization may" to "should."
- 17 In the penultimate sentence, change "include evidence of exceptions..." to "include a description of exceptions."
- 20 In the last sentence, change "may request the service auditor to perform" to "may request that the service auditor perform."
- 26 Service auditors should be able to determine the objectives the service organization has contracted (and is attempting) to achieve, but requiring the service auditor to determine the user auditor's needs as to a description of policies and procedures is a heavy burden.
- 27 Move the phrase "for the type of report described in paragraph 24a," to the beginning of the last sentence for clarity.

- 28 Determining whether changes in the service organization's policies and procedures are significant to user auditor's audits is in the same class as determining the user auditor's needs as to the description of policies and procedures.
- 28 In the first sentence, change "before the beginning of field work" to "through the completion of field work." Note, however, that this paragraph changes the point in time nature of this proposed report to one that more or less covers a period of a year.
- 31 The reference to paragraph 29e should also refer to the second paragraph of the report illustrated in paragraph 38.
- 31 The phrase to be added in these circumstances should be expanded by the addition of "...as delineated in the attached description." The same change should be made in paragraph 46, if the redundant paragraphs are not deleted.
- 32 The "without error" criteria in this paragraph (and in paragraph 47) seems to require a higher standard of performance from a service organization's control structure than would ordinarily be achieved. Insert the word "reliable" before "financial data to user organizations" in the last sentence of this paragraph and delete all of the words that follow.
- 33 Although a service auditor may advise and assist management of a service organization to prepare the necessary description, the proposal should not authorize the service auditor to prepare it.
- 38 The opening and opinion paragraph of the illustrated report introduce without explanation a new term: "system application."
- 38 Delete "the relevant" from the first sentence of the opinion paragraph for the reasons cited in connection with comments on paragraph 26 and 28 above.
- 42 Substitute "most" for "the" before "user organization's" as some users have unique requirements, application systems or transactions that ordinarily need not be addressed in reports for general user auditor purposes.
- EBK

44d
54

Change "complied with satisfactorily" to
"operating effectively."

53

The service auditor is required to make a judgment as to the control policies and procedures that would have the greatest effect on user auditors assessments of control risk. See comments regarding paragraphs 26 and 28.

Paragraph 2 of the Appendix - In the last line, "verifiable" is too strong a word and should be changed to "is subject to audit procedures."

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nysscpa

May 29, 1991

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division, File 4315
American Institute of CPAs
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Proposed Statement on Auditing Standards -
Reports On The Processing of Transaction By
Service Organizations

Dear Ms. Sherinsky:

We are enclosing the comments of the New York State Society of Certified Public Accountants in response to the above AICPA exposure draft. These comments were prepared by the Society's Auditing Standards & Procedures Committee.

Thank you for your consideration.

Very truly yours,

Walter M. Primoff
Walter M. Primoff, CPA
Director of Professional
Programs

WMP/er
enc.

cc: Accounting & Auditing Chairmen

34a

May 24, 1991

We appreciate this opportunity to provide our observations and recommendations on the proposed Statement on Auditing Standards, entitled "Reports on the Processing of Transactions by Service Organizations". Below are our comments:

The expressed purpose of the new standard is principally to incorporate the audit risk concept in SAS #47, entitled "Audit Risk and Materiality in Conducting an Audit" and the terminology and concepts of SAS #55, entitled "Consideration of Internal Control Structure in a Financial Statement Audit". It would appear that the updating of SAS #44, entitled "Special-Purpose Reports on Internal Accounting Control at Service Organizations" is appropriate and that the revised standard, as drafted, accomplishes that, except as noted in the next paragraph.

The appendix, where appropriate, should make specific references to paragraphs within the general guidance which precedes it in this SAS or to the guide on employee benefit plans. For example; expanded guidance could be given to auditors of employee benefit plans who use the work of fiduciaries to reduce their audit testing.

FG:rs

340

May 31, 1991

Auditing Standards Board
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Reports on the Processing of Transactions by Service Organizations

Ernst & Young supports the above-captioned proposed statement. The proposed statement provides needed guidance on issues encountered in practice when an entity uses a service organization for the processing of certain transactions. However, as discussed below, we believe the proposed statement could be improved by allowing user auditors to reduce control risk when using reports on policies and procedures placed in operation, clarifying the change in guidance when reporting on the system of a segment of the service organization, and explaining the rationale behind the six-month testing period. An appendix, with additional comments for the Board's consideration, is attached.

Reducing Control Risk when Using Reports on Policies and Procedures Placed in Operation.

The proposed statement appropriately goes beyond the minimum procedures in SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit*, by requiring the service auditor to both identify control procedures that meet the established control objectives and confirm that the identified control policies and procedures are placed in operation through a walkthrough. However, when using reports on policies and procedures placed in operation, paragraphs 12, 24a, and 37 are too restrictive in not allowing the user auditor to reduce control risk based on the results of these additional procedures. We recommend that paragraphs 12, 24a, and 37 be revised to allow for some reduction of control risk, but not to the extent that is allowed when controls are tested for effectiveness over a period of time.

Reports on the System of a Segment of the Service Organization.

As stated in the summary to the exposure draft, the proposed statement "no longer includes reports expressing an opinion on the system of internal control of a segment of a service organization in the classification 'service auditors' reports'." This is because "these reports generally do not provide the auditor with the means to obtain an understanding of the aspects of the internal control structure at a service organization that may be relevant to a user organization." Service and user auditors would, instead, be subject to the requirements of the full proposed statement.

35a

We believe the implications of this change may not be fully appreciated by user organizations, service organizations, and auditors who prepare or use reports under paragraphs 42-46 of SAS No. 44. In particular:

- Footnote 1 to paragraph 1 of the proposed statement may lead readers to believe that the existing practice of preparing SAS No. 30 reports on the system of a segment of a service organization would still be allowed.
- The Appendix may lead one to believe that it only applies to fiduciaries of employee benefit plans. It is our understanding that the proposed statement will apply to any organization (e.g., mutual fund custodians, transfer agents, or processors) currently reporting under paragraphs 42-46 of SAS No. 44.
- The Appendix also focuses primarily on a service organization perspective and provides little guidance from a user perspective.

We recommend that Footnote 1 and the Appendix be revised to better link them to the body of the proposed statement and to more clearly indicate who they apply to and why. Consideration should also be given to providing additional examples in the Appendix of reports and opinions specifically tailored to service organizations affected by the Appendix.

Six-month Testing Period.

We suggest that the proposed statement explain the rationale behind the six-month testing period by incorporating the following thoughts. The ability to reduce control risk, assuming the related controls are evaluated as effective, is dependent on whether the service auditor tested the controls, the results of the tests, and the time period covered. The shorter the time period covered by tests of effectiveness and the longer the time elapsed since the performance of the tests, the less reliance the user auditor can place on the service organization's controls. Therefore, tests of effectiveness of less than six months ordinarily should not result in a significant reduction of control risk.

* * * * *

We would be pleased to discuss our comments and recommendations with members of the Board or of its staff.

Very truly yours,

Ernst & Young

Attachment

EBB

Appendix

Other specific comments on the proposed statement, "Reports on the Processing of Transactions by Service Organizations," are indicated below by paragraph number.

Paragraph 2--Because of the significance of this statement to service organizations that operate in a fiduciary capacity as described in the Appendix, and because the term "fiduciary" is used both in the title to the Appendix and in paragraph 1 to the Appendix, we believe the term should be defined in paragraph 2 (or a footnote should be added with the ERISA definition appropriately referenced).

Paragraph 6--The sentences beginning at line 13 ("When those services are limited to recording user transactions and processing the related data...") and at line 28 ("When the service organization executes the user's transactions and maintains the related accountability...") appear to be intended to contrast two different degrees of user interaction. The contrast would be clearer if consistent terms were used in both cases, and if a term other than "executes" were used in the second sentence referenced above. For example, the paragraph could be clearer if in the first sentence referenced above "recording, processing, and initiating transactions" were contrasted to "recording, processing, but not initiating" transactions in the second sentence.

Paragraph 8--The seventh bullet may imply that a service auditor's review and report should address "capacity" of the service organization. Except possibly for extreme situations, where capacity is clearly inadequate, we believe user auditors do not need to address capacity for purposes of a financial audit. We suggest that the word "capacity" be deleted.

Paragraph 17--It would be very useful to have an example of a modified report that addresses substantive procedures.

Paragraph 20--Line 16 should state, "user organization" rather than "user auditor."

Paragraph 39--The proposed statement states that exceptions should be described in full in the service auditor's report (i.e., not in an attached section which provides other comments from the service auditor, such as the results of the tests of controls). However, we suggest the proposed statement allow for reference to a section in an attachment when multiple exceptions are noted that would otherwise overwhelm the auditor's report itself.

Also, it would be helpful to have examples of report format and content when the service auditor identifies exceptions to design, exceptions to "suitability of design," and exceptions to other substantive procedures performed.

Paragraph 44f--"A statement of the period covered by the report..." should read "A statement of the period covered by the tests of effectiveness..."

Paragraph 54--The following items should be clarified or modified in the sample report:

Report paragraph 2--The phrase at the end of this paragraph, "...if the control procedures were complied with satisfactorily" appears unnecessary and inconsistent with describing the scope and objectives of the examination. In an effort to simplify this report, this phrase could be eliminated.

Report paragraph 4--The date (September 30, 19xx) should be left blank to be consistent with dates in other paragraphs.

Report paragraph 4--The statement should state that the "as of" date in paragraphs 1, 3, and 6 is at the end of the test period covered by the tests of controls.

Paragraph 59--We recommend that the effective date of the proposed statement be positioned to allow for adequate transition planning (e.g., allow the six-month tests of effectiveness) by service organizations in complying with the proposed statement.

May 29, 1991

Ms. Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
American Institute of Certified Public Accountants
1211 Avenue of Americas
New York, New York 10036-8775



Dear Ms. Sherinsky:

Aetna Life & Casualty is pleased to have this opportunity to comment on the exposure draft of the Proposed Statement on Auditing Standards (SAS), "Reports on the Processing of Transactions by Service Organizations." Aetna is supportive of an SAS which (1) provides guidance on the factors an auditor should consider when auditing the financial statements of an entity that uses a service organization in connection with the processing of transactions, and (2) provides guidance to auditors who issue reports for use by other auditors on procedures performed at service organizations. However, we would like to express the following concerns.

PRIMARY CONCERN

Paragraph 10 of the SAS states that if the user-auditor concludes that information is not available to obtain a sufficient understanding to plan the audit, the user-auditor may visit the service organization and perform procedures to obtain the necessary information.

Although we do not object to a user auditor visiting a service organization to obtain necessary information to perform an audit, we believe that a hierarchy of procedures should be followed before a user-auditor determines that it is necessary to visit the service organization. We recommend that the hierarchy be as follows:

- o The user-auditor should obtain the service auditor's report on policies and procedures in operation.
- o If the service auditor's report does not meet the needs of the user-auditor, the user-auditor should review and, where appropriate, test the mitigating controls in place at the user organization.
- o After testing the controls at the user organization, if the user-auditor still believes it is necessary to visit the service organization, he should do so.

36a

Ms. Judith Sherinsky
May 29, 1991
Page Two

Without having the above hierarchy clearly defined, user-auditors may choose to visit a service organization without having pursued all reasonable alternative means of achieving their objectives. Allowing full access to a large number of user-auditors is not practical and would be a time consuming and costly burden on service organizations.

OTHER CONCERNS

In addition to the above, we have five other concerns.

Frequency of User and Service Auditor Reviews

The proposed SAS does not provide specific guidance as to the applicability of rotational reviews by service auditors. We believe that rotational reviews would be sufficient in many instances with an update of significant changes each year. A yearly review is likely not to be cost effective.

Requesting Service Auditor to Perform Procedures - Paragraph 20

Paragraph 20 states that if the user-auditor believes it is necessary, the user-auditor may request the service auditor to perform agreed upon procedures at the service organization. We do not believe that the user-auditor should be requesting the service auditor to perform procedures at the service organization. Instead, if the user-auditor believes that additional procedures need to be performed, the user-auditor should request the service organization to ask its auditors to perform the procedures.

Service Reports - Paragraphs 24a and 24b

We recommend that reports on policies and procedures in operation be specifically identified as reports on "internal control" policies and procedures. This would clarify that only procedures relating to internal control need to be reported (i.e., other policies and procedures, such as service organization product pricing, would not need to be reported).

Effective Date

The proposed SAS does not state the effective date for the statement. We recommend that the proposed statement be effective for fiscal years beginning on or after January 1, 1993. This would allow companies enough time to coordinate the development of the newly required reports/activities with their auditors.

Ms. Judith Sherinsky
May 29, 1991
Page Three

Appendix - Paragraph 1

The Appendix gives the impression that all providers of services to employee benefit plans subject to ERISA are fiduciaries. We do not agree with this representation and recommend that the wording be clarified to reflect that not all providers of service to ERISA plans are fiduciaries.

We appreciate the opportunity to comment on the Proposed SAS and are available to answer any questions or provide additional input to assist the Auditing Standards Board in further consideration of the issues.

Sincerely,



NPB

June 5, 1991

Ms. Judith Sherinsky
Technical Manager
American Institute of Certified
Public Accountants
Auditing Standards Division
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Sherinsky:

We are pleased to submit our comments on the proposed statement on auditing standards, Reports on the Processing of Transactions by Service Organizations. We believe that it is appropriate to revise SAS No. 44, Special-Purpose Reports on Internal Accounting Control at Service Organizations, to reflect the guidance provided by SAS No. 47, Audit Risk and Materiality in Conducting an Audit, and SAS No. 55, Consideration of the Internal Control Structure in a Financial Statement Audit.

We believe this exposure draft provides useful guidance. However, there are a number of changes that should be made before the statement is adopted. We are particularly concerned about the reporting guidance in paragraphs 40 and 54 and have presented our comments on those paragraphs first.

PARAGRAPH 40. The report contemplated in this paragraph is of limited value in helping the user auditor assess control risk. User auditors, having no knowledge of the control objectives of the service organization, may place undue reliance on this type of report. Accordingly, we recommend deleting this paragraph, the reference to it in footnote 3 to paragraph 29, and the related paragraph 10 of the appendix.

PARAGRAPH 54. We believe the service auditor who tests the operating effectiveness of policies and procedures should report on operating effectiveness. As written, the report now requires the service auditor to state (a) that the description of the system application was examined; (b) that the description presents fairly, in all material respects, the relevant aspects of the policies and procedures that had been placed in operation; (c) that control structure policies and procedures were suitably designed to achieve specified control objectives; and (d) that the nature, timing and extent of tests of effectiveness were appropriate in the circumstances. The report leaves the user auditor to infer, from reading the results of tests applied, whether policies and

57 Jan

procedures operated effectively during the period under examination. The service auditor, who designed the tests of effectiveness based on his or her understanding of the system and the control objectives, is in a better position to conclude on operating effectiveness.

We believe that, if a service auditor issues an opinion on operating effectiveness, providing a list of detailed procedures in support of that opinion is unnecessary, detracts from the opinion, and is inconsistent with professional standards. Therefore information regarding the nature, timing, and extent of tests should not be included in the report.

The user auditor who receives a report, revised as discussed above, will have sufficient information to assess control risk pursuant to SAS No. 55. In particular, he or she will have knowledge of the control objectives, and will know whether the system, as described, meets those control objectives and whether the relevant policies and procedures operated effectively. The description of the control structure policies and procedures, and the fact that they have been tested sufficiently, provides a basis for the user auditor's control risk assessment. If, after reading the report, the user auditor requires additional information to assess control risk, he or she can make inquiries of the service auditor.

Accordingly, we recommend the third and fourth paragraphs of the illustrative report in paragraph 54 be replaced with the following:

In addition to the procedures referred to in the previous paragraph, we applied tests to the described control structure policies and procedures to obtain reasonable assurance that those policies and procedures were complied with satisfactorily for the six-month period ended September 30, 19XX. We believe our procedures were appropriate in the circumstances.

In our opinion, the accompanying description of the aforementioned application presents fairly, in all material respects, the relevant aspects of XYZ Service Center's policies and procedures that had been placed in operation as of _____. Also, in our opinion, the control structure policies and procedures, as described, are suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described control structure policies and procedures were complied with satisfactorily. Furthermore, we obtained reasonable assurance that those control structure policies and procedures were complied with satisfactorily for the six-month period ended September 30, 19XX.

As a result of the above, other sections of the statement would also require modification.

OTHER COMMENTS

PARAGRAPH 3. The third sentence of this paragraph could be interpreted to apply to packaged software that is installed on a user organization's computer, but was designed and is maintained by an outside party. In those circumstances, the transactions would be processed by the "user" organization and not by a service organization. For that reason, we recommend the sentence be deleted.

PARAGRAPH 10. The second sentence states that "the user auditor should request that the service organization have its auditors perform procedures to supply" information needed by the user auditor. Such requests for additional information would likely be most effective coming from the user organization, not its auditor. We recommend the sentence be modified to indicate that user auditors should communicate with service auditors through their respective clients, as follows:

If the user auditor concludes that information is not available to obtain a sufficient understanding to plan the audit, the user auditor should consider requesting that the user organization contact the service organization to obtain the service organization's cooperation in getting the service auditor to perform procedures to supply the necessary information, or the user auditor may visit the service organization and perform such procedures.

The last sentence of paragraph 20 should also be modified for the reasons discussed above. That sentence should be replaced with the following:

Also, if the user auditor believes it is necessary, the user auditor should request that the user organization contact the service organization to obtain the service organization's cooperation in getting the service auditor to perform agreed-upon procedures at the service organization, or the user auditor may visit the service organization and perform such procedures.

PARAGRAPH 27. The first sentence of this paragraph states that "Procedures to determine whether the policies and procedures are placed in operation ordinarily would include tracing a limited number of transactions ..." It frequently is difficult to trace transactions, in the traditional sense, through information systems. Additionally, SAS No. 55 does not include tracing transactions as a means to verify that policies and procedures have been placed in operation.

We recommend that guidance similar to that in paragraph 23 of SAS No. 55 be provided. Accordingly, we recommend that the first sentence of paragraph 27 be modified to read as follows:

Knowledge of whether the policies and procedures are placed in operation is ordinarily obtained through previous experience with the service organization and procedures such as inquiries of appropriate management, supervisory, and staff personnel; inspection of service organization documents and records; and observation of service organization activities and operations.

PARAGRAPH 38. To conform to other references to control structure "policies and procedures" in the report, we recommend the last sentence of the second paragraph of the illustrative report be modified to include reference to compliance with policies as well as procedures. Additionally, we recommend the word "control" be deleted to enhance the readability of the report, and because the term "control" is incomplete since it refers to the "control structure." Accordingly, the last sentence of the second paragraph would read as follows:

Our examination included procedures to obtain reasonable assurance that the control structure policies and procedures were suitably designed to achieve the specified control objectives, if those policies and procedures were complied with satisfactorily.

These same changes should be made to the second paragraph of the illustrative report in paragraph 54.

PARAGRAPH 41 AND THEREAFTER. The statement would be easier to use, and would more clearly differentiate between the reports on design effectiveness only and those that also address operating effectiveness, if the section entitled "Reports on Policies and Procedures Placed in Operation and Tests of Operating Effectiveness" did not repeat much of the same information contained in the section entitled "Reports on Policies and Procedures Placed in Operation." We believe it would be more effective to provide only the additional information necessary for the service auditor who issues a report on policies and procedures placed in operation and tests of operating effectiveness.

PARAGRAPH 43. The first sentence of this paragraph states that the service auditor's report is "as of a specified date." This is incorrect with respect to tests of operating effectiveness, which cover a period of time. However, the reference to operating effectiveness is unnecessary because the purpose of this paragraph is to ensure the accurate description of the service organization's control structure policies and procedures as of a point in time. Accordingly, we recommend deleting the phrase "and tests of operating effectiveness" in the first sentence.

PARAGRAPH 53. The second sentence of this paragraph states that testing "ideally" should be applied to control policies and procedures throughout the period being covered by the report. We recommend deleting the word "ideally."

PARAGRAPH 54. The first sentence of the sixth paragraph of the illustrative report is confusing because it refers to the "aforementioned information" being as of a specific date. However, the fourth paragraph of that report relates to testing the effectiveness of specific policies and procedures for a period. The wording below eliminates this confusion:

Projection of the aforementioned information to the future is subject to the risk that...

PARAGRAPHS 56 AND 58. These paragraphs should be deleted. The issues related to auditor assurance regarding compliance with specific laws and regulations are too complex and significant to be effectively addressed in such an abbreviated manner. This matter should be the subject of a separate project undertaken by the Board or the Institute. Also, paragraph 18 should be deleted for the reasons discussed above.

PARAGRAPH 57. Footnote 4 to paragraph 57 discusses material weaknesses in relation to "the financial statements being audited." The reference to material weaknesses should be deleted, because it is not possible for the service auditor to assess how a significant deficiency in the design or operating effectiveness of the control structure policies and procedures would affect user organization financial statements. We believe that the concept of significant deficiencies in the design or operation of the policies and procedures (as discussed in paragraph 32) is more appropriate. Accordingly, we recommend that footnote 4 be deleted, and the last bullet point of paragraph 57 be modified, as shown below.

Additionally, it is unlikely that the cost to correct a significant deficiency that could preclude the service organization from achieving its specified control objectives would exceed the benefit derived from such a change. We recommend that this concept be deleted from paragraph 57. Accordingly, the last bullet point of paragraph 57 should be modified to read as follows:

State that management has disclosed to the service auditor all significant deficiencies in the design or operating effectiveness of the control structure policies and procedures, of which they are aware, that would preclude the service auditor from obtaining reasonable assurance that stated control objectives would be met.

If you have any questions regarding our comments, please contact James S. Gerson (212-536-2243) or Charles W. Snader (212-536-2743) in our National office.

Very truly yours,

Copps + Snader

June 3, 1991



California
Society
Certified
Public
Accountants

Judith Sherinsky, Technical Manager
Auditing Standards Division, File 4315
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Sherinsky:

The California Society of Certified Public Accountants' Accounting Principles and Auditing Standards (APAS) State Committee takes this opportunity to comment on the exposure draft of a proposed statement of auditing standards entitled "Reports on the Processing of Transactions by Service Organizations."

The APAS Committee is the senior technical committee of the California Society of Certified Public Accountants. The 1990-1991 committee is comprised of 40 members, of which 20% are from national CPA firms, 55% are from local or regional firms, 15% are sole practitioners in public practice, 3% are in industry and 8% are in academia. The following comments represent the results of the committee's deliberation on the proposed statement.

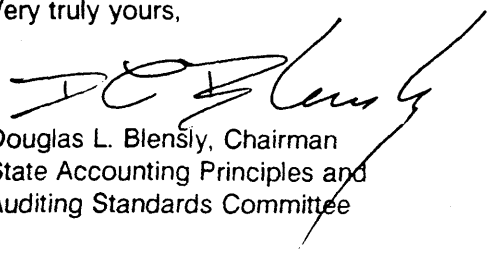
Basically, we support the issuance of the proposed statement and feel that it is well written. However, we have the following comments to make about a portion of it.

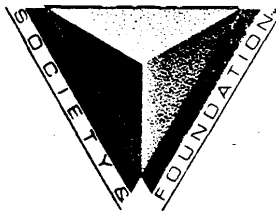
We feel that paragraph 3 should give more definition and direction into those situations in which the statement does not apply. Our committee noted the phrase "This Statement also is not intended to apply to the audit of transactions arising from financial interest in partnerships and corporations, and joint ventures...". However, our committee could not agree on the applicability to farm cooperative organizations.

In those parts of the statement, such as paragraph 40, which describes replacing one paragraph for another or deleting other certain paragraphs, we feel as a matter of clarification that the whole complete report letter should be stated the way you are intending it to read.

We appreciate the opportunity to comment on the statement and will be available to further discuss the issues, if needed.

Very truly yours,


Douglas L. Blensly, Chairman
State Accounting Principles and
Auditing Standards Committee



May 22, 1991

Ms. Judith Sherinsky
Technical Manager
Auditing Standards Division
AICPA
1211 Avenue of the Americas.
New York, NY 10036-8775

Exposure Draft--Proposed Statement on
Auditing Standards
"Reports on the Processing of Transactions
by Service Organizations"
File Reference #4315

Dear Ms. Sherinsky:

The Auditing Services Committee of the Illinois CPA Society is pleased to submit its response to the request for comments on the above Exposure Draft.

In general, we believe that it would be extremely useful to both potential user auditors and potential service auditors if at least abbreviated examples of the document on which the service auditor would be reporting were included in the pronouncement. This would give potential user auditors an indication in advance of whether a report on such document would be useful for their purposes and would help service auditors in deciding whether client descriptions were satisfactory under the guidelines of this pronouncement.

Paragraph 6 discusses the issue of the extent to which relevant control policies and procedures are housed at both the user organization and the service organization or primarily at the service organization. This is a very condensed discussion and almost presumes that the reader is familiar with the predecessor AU 324 discussion. We feel that this paragraph should be expanded to clarify the issue and should contain some examples as part of the discussion.

In paragraph 8, bullet item 7, one of the factors which the user auditor might consider in the process of planning the audit is the service organization's insurance coverage. We do not understand the relevance of the service organization's insurance coverage to the process of audit planning. The discussion in this paragraph could benefit from the inclusion of specific examples of how these factors could impact audit planning.

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May 22, 1991

Paragraphs 29c and 44c require the service auditor to determine whether the service organization's description of control policies and procedures presents fairly, in all material respects, the aspects of the service organization's policies and procedures that may be relevant to the user's internal control structure. We are very uncertain how to begin judging materiality in this circumstance. It is clearly to be done in nonmonetary terms. We feel the the standard should provide guidance on this matter.

Paragraphs 35 and 50 require that the service auditor be satisfied that the control objectives as set forth by the service organization are reasonable in the circumstances and consistent with the service organization's contractual obligations. This latter requirement may be reasonable if the service organization uses standard contracts with all or most of its users. But where contracts are individually drafted, the reading of hundreds of contracts to determine contractual obligations would be a very inefficient audit procedure.

We are concerned about the requirements of paragraph 44c. We are uncertain about the exact level of detail being demanded. An example of the disclosure anticipated should be made part of this standard. It seems, though, that what amounts to a subset of the auditor's working papers are being made a matter of public record. One consideration is whether this violates confidentiality of information provisions. A second consideration is whether firms would be willing or should be required to divulge their audit methodology as reflected in the test of controls. A third consideration is the legal liability to which the service auditor is subjected by this provision. We believe that the liability concerns are very real and very significant.

In paragraph 55, the example given relates to a deficiency in design. An example of reporting on deficiencies in operation would be very useful.

Finally, we believe that the inclusion of the appendix is premature. Since a new Accounting and Auditing Guide covering employee benefit plans is forthcoming, requests for comments about the appendix should be delayed until the Guide is released. This information should then be made part of the Audit Guide.

The above represents the views of the Illinois CPA Society rather than that of any of the individual members of the committee or any of the firms or organizations with which they are associated.

Very truly yours,



John Kiss, Chairperson
Auditing Services Committee

JK/pk