



**International Federation of Accountants**

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**Agenda Item**

**13**

**Committee:** IAASB  
**Meeting Location:** Madrid, Spain  
**Meeting Date:** September 24-28, 2007

**ISA 402 (Revised and Redrafted), “Audit Considerations Relating to an Entity Using a Third Party Service Organization”**

**Objectives of Agenda Item**

To discuss a revised draft of proposed ISA 402 (Revised and Redrafted), “Audit Considerations Relating to an Entity Using a Third Party Service Organization,” and to approve the revised draft for issuance as an Exposure Draft.

**ISA 402 (Revised and Redrafted) Task Force Members**

The members of the Task Force are:

- Denise Esdon (Task Force Chair), IAASB member
- Susan Jones, IAASB member
- Kjell Larsson, IAASB member, supported by Kelly Ånerud, IAASB technical advisor
- Kevin O’Donovan, KPMG, Ireland
- Jens Poll, Moore Stephens, Germany
- George Tucker, Chair of ISAE 3402 Task Force
- Correspondence members: Claire Grayston, AUASB, Australia and Bernard Agulhas, IRBA, South Africa

**Activities since Last IAASB discussions**

The Task Force held a teleconference in July to discuss the comments received from the IAASB in April on the first draft of proposed ISA 402 (Revised and Redrafted). The Task Force also communicated via email to finalize the wording of the revised draft of the ISA now being presented.

In addition, the Chair of the ISA 402 Task Force and Staff have continued to monitor the developments of ISAE 3402 and have incorporated changes in the revised ISA where appropriate to ensure consistency between the two standards.

## **Matters for IAASB Consideration**

### **1. TYPE A REPORTS**

At the April meeting, the IAASB was in agreement that in some cases, a user auditor may mistakenly rely on a Type A report as evidence about the operating effectiveness of controls. The Task Force agrees with the concerns of the IAASB and has repositioned the requirement relating to the user auditor's use of the Type A report to the section "Obtaining an Understanding of the Services Provided by the Service Organization.

A few IAASB members were of the view that the statement in paragraph A16: "Such a report, however, does not provide any evidence of the operating effectiveness of the relevant controls" could be elevated as essential explanatory material, however, the Task Force was of the view that the repositioning of the requirement would illustrate to the user auditor that a Type A report can only be used as an input into the auditor's risk assessment procedures and cannot be used as evidence of the operating effectiveness of controls.

In addition, certain application guidance relating to the auditor's evaluation of whether the description of controls at the service organization is at a date that is appropriate for the user auditor's purposes has been elevated to a requirement for both Type A and Type B reports.

## **Matters for IAASB Consideration**

Q1. Does the IAASB agree that the reordering of the requirements as requested at the April meeting has been done appropriately?

### **2. APPLICABILITY OF THE ISA TO THE AUDITS OF SHARED SERVICE CENTERS**

At the April meeting, the IAASB was of the view that paragraph 4, which was included to address the applicability of the ISA to shared service centers, was confusing and should be deleted. The Task Force has done so, and, at the request of the IAASB, has also changed the title of the ISA to specifically restrict the ISA to third-party service organizations.

One task force member continues to be of the view that it is not appropriate to limit the scope of the standard to third-party service organizations or to define a service auditor only in terms of the assurance report on controls and not in the context of the execution of control and substantive procedures on behalf of the user auditor. The member views the concerns regarding the reference to shared service centers in the previous draft as unfounded as from a legal and regulatory perspective and with particular reference to the statutory audit requirement, an intra group shared service center is viewed as the equivalent of a third party service organization, albeit related, by a fellow component unless the intra group financial shared services center is under the direct control of the component. The task force member also believes that the extended definition in the previous draft more accurately reflects what often now happens in practice, and notes that this is referred to in the Application and Other Explanatory Material.

In seeking to be responsive to the perceived needs of the auditor in circumstances where a user entity uses a shared service center, the Task Force has drafted Appendix 2 to illustrate how the concepts in proposed ISA 402 (Revised and Redrafted) may apply. The audits of shared service centers and the link with service organizations appears to be contemplated by the

requirement in paragraph 12 of ISA 600 (Revised and Redrafted), “The Audit of Group Financial Statements ... “ and the application material in paragraph A11, which states:

12. In applying [proposed] ISA 220 (Redrafted), the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence.

A11. The group engagement team’s understanding may include matters such as the following:

- ...
- The use of service organizations, including shared service centers.

As a result, the Task Force has included background information related to the audit of shared service centers and explanatory language as to how the concepts in proposed ISA 402 (Revised and Redrafted) and ISA 600 (Revised and Redrafted) may apply.

#### **Matters for IAASB Consideration**

Q2. Does the IAASB agree with the proposed approach to the Appendix as described above? Is the content included in the ISA appropriate?

### 3. OTHER MATTERS

The Task Force was asked to review the ISA to determine if it gave appropriate weight to the user auditor’s understanding and testing of controls in place at the user entity. The Task Force has reviewed the wording in the requirements and notes that paragraph 9 of the proposed ISA and the related application material address the types of controls that may be understood by the user auditor. The Task Force is of the view that the application of the auditor’s judgment will determine which controls need to be understood and tested and to highlight one type of controls as perhaps most important may bias the ISA unfairly.

The requirement for the user auditor to be satisfied as to the service auditor’s professional reputation, competence and independence in paragraph 14 of the proposed ISA has been changed to reflect the concerns of the IAASB. The requirement now applies to all service auditors, not only those not well-known to the user auditor, but the extent of the procedures will vary depending on the circumstances.

**Material Presented**

Agenda Item 13-A      Proposed ISA 402 (Revised and Redrafted) (Mark-up from April IAASB Meeting)  
(Pages 2990 – 3014)

Agenda Item 13-B      Proposed ISA 402 (Revised and Redrafted) (Clean Copy)  
(Pages 3015 – 3036)

**Action requested**

The IAASB is asked to review the revised draft of proposed ISA 402 (Revised and Redrafted) and approve the proposed ISA for issue as an exposure draft.