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Mr. Jim Sylph  
Executive Director Professional Standards  
International Auditing and Assurance Standards Board (IAASB)  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017  
USA

By email

Dear Mr Sylph

**PROPOSED REVISED AND REDRAFTED ISA 402 AUDIT CONSIDERATIONS  
RELATING TO AN ENTITY USING A THIRD PARTY SERVICE ORGANIZATION**

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the Proposed Revised and Redrafted ISA 402 published by IAASB in December 2007.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

**We believe that the clarification reformatting has resulted in a more readable and user-friendly document than previous versions. However, changes to the objective and requirements will help ensure consistency of interpretation and improved audit quality, as explained below.**

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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## Objective

*Is the objective to be achieved by the auditor, stated in the proposed redrafted ISA, appropriate?*

**No.** The introductory words would be more clearly expressed as. 'The objective of the auditor of an entity that uses a service organization is to...'.

## Requirements

*Have the criteria identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements promote consistency in performance and the use of professional judgment by auditors?*

### Not in the following cases:

1. Paragraph 11 sets out procedures that an auditor would perform if unable to obtain an understanding of the user entity's internal control relevant to the audit from information on the service organization available at the user entity. Paragraph A16 is a conditional requirement dealing with what happens when, having exhausted the options in paragraph 11, the auditor still cannot obtain a sufficient understanding. This should be moved to the end of paragraph 16 as a requirement.
2. The words 'for which controls are applied only at the service organization' in paragraph 12 are confusing and should be deleted. There are virtually no cases in which controls operate entirely independently in the absence of any other control. We read the requirement as meaning that where controls relevant to a particular assertion operate at both the service organisation and at the user, and testing of the user control would be sufficient, testing of the service organization's control (using one of (a) - (c)) is not required. Furthermore, in such a situation, the user auditor's risk assessment would not include an expectation about the effective operation of a control operated by the service organization, and hence no testing would be required even if the words above were *not* included in the standard. Nevertheless, for the sake of clarity, the words above should be removed and an additional paragraph of application material included stating that:

*The user auditor's risk assessment may include expectations that controls are operating effectively for certain assertions. Where controls operating over an assertion are operated by both the user and the service organization, the user auditor may consider whether their expectation is that the controls operated by both are operating effectively, or whether their expectation is limited to controls operated by only one party. This may include the situation where the user operates a monitoring control that the user auditor believes will be sufficient for the purposes of their risk assessment if it operates effectively, even if the service organization's control does not.*

3. Paragraph 19 should be redrafted to read, 'The user auditor shall enquire of management of the user entity whether the user entity is aware of, or the service

organisation has reported to the user entity, any fraud...'. This deals with the situation where the user entity is aware of any fraud or error, regardless of whether they discovered it themselves or were told by the service organization.

4. Paragraph 15 refers to a service auditor's 'professional reputation'. This is inconsistent with ISA 600 which does not explicitly require a group auditor to consider a component auditor's reputation, although it may, in practice, form part of a consideration of competence.

#### **Specific matter on which comment was requested**

*Paragraph 4 of proposed ISA 402 (Revised and Redrafted) allows for the ISA to be adapted, as necessary in the circumstances, to situations where an entity uses a shared service center which provides services to a group of related entities. In particular, the IAASB would welcome views as to whether:*

- a. *The ISA is capable of being adapted for these circumstances; and*
- b. *If there are additional opportunities within the Application and Other Explanatory Material where additional guidance relating to shared service centers could be added to enhance the ISA without duplicating material in other ISAs.*

The ISA is capable of being adapted for these circumstances taken together with ISA 600 (Revised and Redrafted). IAASB should add an appendix setting out additional guidance covering:

1. A definition of a shared service centre in paragraph 8 and an amendment to the definition in 8 (b) to clarify that service auditors include auditors of shared service centres performing both tests of control and substantive procedures.
2. Sharing the group auditor's understanding of the entity, including its internal control over financial reporting, obtained as part of the risk assessment performed in accordance with paragraphs 17 and 18 of ISA 600 (Revised and Redrafted) with other component auditors where this may be relevant to their work. In particular, the group auditor recognises that where they request a component auditor to carry out an audit, that component auditor will be required to obtain an understanding of the component and its internal control over financial reporting as part of their own risk assessment. This will be the case when asking for (a) an audit of the financial information of the component, or (b) an audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement of the group financial statements. It may or may not be the case when asking for specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements as it will depend on which procedures are specified.
3. Sharing the group auditor's conclusion as to the operating effectiveness of controls with the component auditor where the component auditor has performed its own risk assessment on the subject matter it has been asked to audit (whether the financial information of the component, or one or more account balances, classes of transactions or disclosures as above).
4. Substantive testing by the group auditor of certain account balances, classes of transactions or disclosures where a component auditor has been asked to audit

the financial information of a component. It is assumed that if the group auditor is only requesting a component auditor to audit certain account balances, classes of transactions or disclosures, they will scope out of their request those areas which they will be testing themselves (to remove circular reporting).

5. Which of the areas noted above are likely to be encountered frequently in practice including IT controls and the monitoring of controls (and activities carried out by a group internal audit function relevant to the work of component auditors).
6. Acknowledgement of the need for component auditors to consider the interaction between component-operated controls and service centre-operated controls (such as the need for a combination of password controls operated by the service organization and controls at components over who can request the service organization to change a user's access rights).

### **Application material**

As noted above, paragraph A16 should be elevated to a requirement. If it is not, it needs to be rephrased to avoid using the words, 'the auditor is required to...'.

Paragraph A17 could usefully refer to the possibility of a user auditor relying on the work of a service organization's internal audit function with a cross-reference to ISA 610.

Application material should be given for situations where a service auditor is asked to perform agreed-upon procedures rather than a Type A or Type B assurance report. This guidance should refer to ISRS 4400.