



July 10, 2008

Mr. Jim Sylph  
Executive Director, Professional Standards  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, NY 10017

Dear Mr. Sylph:

We appreciate this opportunity to comment on proposed International Standard on Assurance Engagements (ISAE) 3402, Assurance Reports on Controls at a Third Party Service Organization (the “proposed standard”) and the proposed conforming amendment to Preface to the International Standards on Quality Control, Auditing, Review, Other Assurance and Related Services, as developed by the International Auditing and Assurance Standards Board (IAASB).

Within our recommendations for editorial changes, additions are noted in “bold underline” and deletions in “strike-through.”

**RESPONSES TO SPECIFIC QUESTIONS:**

1. Do you support the proposal that the ISAE be written for application to assertion-based engagements? Are there situations in which it would not be possible or practicable for management of the service organization to provide an assertion?

*Yes, we support the application of the ISAE only to assertion-based engagements.*

2. Do you support the inclusion in the proposed standard of a number of requirements based on ISAs dealing with matters such as using the work of the internal audit function, sampling, documentation, and using the work of a service auditor’s expert? Has the IAASB identified all such matters as are relevant? Should these matters be dealt with in proposed ISAE 3402 or in ISAE 3000?

*We believe it would be more appropriate to amend ISAE 3000, as these types of requirements would be equivalent to most assurance engagements covered by ISAE 3000. We understand that this is not the highest priority of the IAASB at this point.*

*Accordingly, we suggest that once ISAE 3000 is revised, that the irrelevant material be deleted from ISAE 3402 at that point.*

3. Should ISAE 3000 be amended with respect to the auditor's external experts as outlined in the question above?

*Yes. Similar to our answer to question 2 above, we believe that ISAE 3000 should be ultimately amended to include guidance on the auditor's external experts.*

4. What are your views on the proposed requirements regarding the minimum elements of suitable criteria?

*While we agree with having minimum elements of suitable criteria, we do not believe that the items listed in paragraph 15 are "criteria for fair presentation." Rather, we believe that they are a list of "content" of the description of the system. It seems that the "evaluation" of whether the description of the system is "fairly presented" is contained in paragraph 33, which states that the auditor shall obtain and read the description, and evaluate whether the aspects of the description are presented fairly.*

*Because of this, we believe the introduction to paragraph 15 should be revised as noted below, to be clear that paragraph 15 relates more to "completeness" of the description as opposed to "fairness" of the description (paragraph 33):*

15. Suitable criteria for evaluating whether the description of the system is ~~fairly presented~~ **provides sufficient information for a broad range of user entities and their auditors** shall encompass at a minimum whether the description:

(a) Presents how the system has been designed and implemented to process relevant transaction, including as appropriate:

*(i) through (vii)...*

(b) Does not omit or distort information relevant to the scope of the service organization's system being described, while acknowledging that the description is presented to meet the common needs of a broad range of user entities and their auditors and may not, therefore, include every aspect of the service organization's system that each individual user entity and its auditor may consider important in its particular environment.

5. Should the description of tests of control included in a Type B report include the disclosure of sample sizes determined by the service auditor only when a deviation from controls is found?

*Yes, we agree with the IAASB proposal to disclose sample sizes only when a deviation from controls is found. This is the same approach used when issuing SAS 70 reports.*

**COMMENTS BY PARAGRAPH:**

- **Sub-service Organizations**

The proposed standard includes guidance on sub-service organizations, which we believe is important, due to the growing number of sub-service organizations being used. However, we recommend that additional guidance be added for situations when the inclusive method is used, especially related to the responsibilities of the management of the sub-service organization. For example, obtaining an assertion and a written representation from the management of the sub-service organization.

- **Understanding the Service Organization's Risk Assessment Process**

As part of an audit of the financial statements, user auditor's are required to obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements, whether due to error or fraud. To assist user auditors in accomplishing that goal, a service auditor should perform procedures to obtain information about the risk that the description of the system is not fairly presented or that stated control objectives would not be achieved due to fraud, illegal acts or intentional misconduct by service organization personnel.

Accordingly, we recommend that the proposed standard include a requirement for the service auditor to make inquiries of service organization management about their assessment of the risk of fraud and their process for identifying and responding to the risks of fraud. There should also be a requirement to inquire of management and internal audit, if present, about their knowledge of any actual, suspected or alleged fraud affecting the service organization.

However, the application material related to these requirements should clarify that, due to the inherent limitations of an assurance engagement (for example, the nature of the procedures performed and the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost), the service auditor cannot reduce assurance engagement risk to zero. The service auditor, therefore, cannot obtain absolute assurance about the absence of fraud, illegal acts or intentional misconduct by service organization personnel.

- **Paragraph A13**

In order to be clear that the "outside parties" referred to in the first bullet of paragraph A13 (the ones which may have designated the stated control objectives) are outside parties that have "established processes" which are more likely to lead to generally accepted control objectives, we recommend the following editorial change:

A13. Paragraph 33(a) requires the service auditor to evaluate whether the stated control objectives are reasonable in the circumstances. Considering the following questions may assist the service auditor in this evaluation:

- Have the stated control objectives been designated by the service organization or by outside parties **which develop and publish control objectives for specified activities**, such as regulatory authorities, a user group, a professional body or others?
- Where the stated control objectives have been specified by management, do they relate to the types of assertions commonly embodied in the broad range of user entities' financial statements to which controls at the service organization could reasonably be expected to relate? Although the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements, the service auditor's understanding of the nature of the service organization's system, including controls, and services being provided is used to identify the types of assertions to which those controls are likely to relate.
- Where the stated control objectives have been specified by management, are they complete? A complete set of control objectives can provide a broad range of user auditors with a framework to assess the effect of controls at the service organization on the assertions commonly embodied in user entities' financial statements.

- **Paragraphs 39, A23(b) and (c) and A24**

The three references related to sampling in paragraph A23 (b) and (c) and A24 erroneously use the term "attribute sampling" instead of "sampling" alone. We believe that the use of "attribute sampling" is an error because related paragraphs 22(c), 26 and 27 in extant ISA 530 use the term "audit sampling" in equivalent circumstances. However, as this is not an audit standard, it would not be appropriate to use the term "audit sampling." Accordingly, we recommend that all references to "attribute" be deleted in the proposed standard.

- **Paragraph 56(c)(iii)**

Bullet(c)(iii) of paragraph 56 states that if the description of the system refers to the need for complementary user entity controls, the service auditor's report should include a statement that:

*"The service auditor has not evaluated the suitability of design or operating effectiveness of complementary user entity controls. The stated control objectives can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organization."*

We fully support this guidance, but recommend that the proposed standard include additional guidance on the placement of such a statement within the service auditor's report. This could be done through an additional example in the Appendix. We recommend that it be placed within the audit opinion.

We also encourage the IAASB to consider whether there should be a specific statement that the service auditor cannot opine on user entity controls.

- **Paragraphs 59 and A31**

Paragraphs 59 and A31 relate to “Other Communication Responsibilities” when the service auditor becomes aware of non-compliance with laws and regulations, or uncorrected errors that are not clearly trivial and may affect one or more user entities. The requirement in paragraph 59 is to determine whether this information has been clearly communicated to affected user entities, and if not, to take appropriate action. Application material in paragraph A31 provides examples of appropriate action.

However, we believe that some “appropriate action” as listed in paragraph A31 should be taken, regardless of whether the information has been clearly communicated to affected user entities or not. Accordingly, we recommend that the heading above paragraphs 59 and A31 be changed to “Other Responsibilities” and that the following changes be made to both paragraphs:

59. If the service auditor becomes aware of non-compliance with laws and regulations, or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether this information has been communicated appropriately to affected user entities. ~~If the information has not been so communicated and management of the service organization is unwilling to do so, the service auditor,~~ **and** shall take appropriate action.

A31. Appropriate action when the service auditor becomes aware of non-compliance with laws and regulations, or uncorrected errors that has not been communicated appropriately to affected user entities, and management of the service organization is unwilling to do so **are not clearly trivial and may affect one or more user entities**, may include **one of more of the following**:

- **Requesting that management of the service organization communicate such information to affected user entities.**
- Obtaining legal advice about the consequences of different courses of action.
- Communicating with those charged with governance of the service organization.
- Communicating with third parties (for example, a regulator) when required to do so.
- Modifying the service auditor’s opinion, or adding an other matters paragraph.
- Withdrawing from the engagement.

- **Paragraph A10**

We recommend adding another bullet to paragraph A10, to include “reperformance” as an additional procedure used by the auditor to obtain an understanding of the service organization’s system, as this is a common procedure employed.

- **Appendix 2**

We recommend providing report examples for the inclusive and carve out methods when using sub-service organizations.

We would be pleased to discuss our letter with you or your staff at your convenience. If you have any questions, please contact Jens Simonsen, Director of Global Audit Services at + 1 212 492 3689 or John Fogarty, Chairman – DTT Assurance Technical Policies and Methodologies Group at + 1 203 761 3227.

Very truly yours,

A handwritten signature in black ink that reads "Jens Simonsen". The signature is written in a cursive style with a large, stylized initial "J".