

AUDIT CONSIDERATIONS RELATING TO AN ENTITY USING A SERVICE ORGANIZATION: CAS 402

Definitions

- **User auditor** – An auditor who audits and reports on the financial statements of a user entity
- **Service auditor** – An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization
- **User entity** – An entity that uses a service organization and whose financial statements are being audited
- **Report on the description and design of controls at a service organization (type 1 report)** – A report that comprises:
 - a) A **description, prepared by management** of the service organization, of the **service organization's system, control objectives** and **related controls** that have been **designed** and **implemented** as at a specified date; and
 - b) A **report by the service auditor** that includes the **service auditor's opinion** on the **description** of the service organization's system, control objectives and related controls and the **suitability** of the design of the controls to achieve the specified control objectives
- **Report on the description, design, and operating effectiveness of controls at a service organization (type 2 report)** – A report that comprises:
 - a) A **description, prepared by management** of the service organization, of the **service organization's system, control objectives** and **related controls**, their **design** and **implementation** as at a specified date or throughout a specified period and, in some cases, their **operating effectiveness** throughout a specified period; and
 - b) A report by the service auditor that includes:
 - The **service auditor's opinion** on the **description** of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the **operating effectiveness** of the controls; and
 - A **description** of the **service auditor's tests of the controls** and the results

Requirements

Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control

- When obtaining an understanding of the user entity, obtain an understanding of how a user entity uses the services of a service organization, including:
 - The **nature of the services provided** by the service organization and the **significance of those services** to the user entity, including the effect on the user entity's internal control
 - The **nature and materiality of the transactions** affected by the service organization
 - The **degree of interaction** between the service organization and the user entity
 - The **nature of the relationship** between the user entity and the service organization, including the relevant contractual terms for the activities
- Evaluate the design and implementation of **relevant controls at the user entity** that relate to the services provided by the service organization
 - If a user entity, for example, uses a service organization to process its payroll transactions, the user entity may establish its own controls over the submission and receipt of payroll information that could prevent or detect material misstatements
- Determine whether a **sufficient understanding** of the **nature** and **significance** of the services provided by the service organization and their **effect on the user entity's internal control relevant to the audit** has been obtained to provide a **basis for the identification and assessment of risks of material misstatement**

- If the user auditor is **unable to obtain a sufficient understanding** from the user entity, obtain that understanding from one or more of the following procedures:
 1. Obtaining a **type 1 or type 2 report** (see above for definitions)
 2. **Contacting the service organization**, through the user entity, to obtain specific information;
 3. Visiting the service organization and **performing procedures** that will provide the necessary information about the relevant controls at the service organization; or
 4. **Using another auditor to perform procedures** that will provide the necessary information about the relevant controls at the service organization
- If the user auditor plans to use a type 1 or type 2 report, the auditor must do the following:
 - Evaluate whether the description and design of controls at the service organization is at a date or for a period that is appropriate for the user auditor's purposes
 - Evaluate the sufficiency and appropriateness of the evidence provided by the report for the understanding of the user entity's internal control relevant to the audit
 - Determine whether complementary user entity controls identified by the service organization are relevant to the user entity and, if so, obtain an understanding of whether the user entity has designed and implemented such controls

Responding to the Assessed Risks of Material Misstatement

- In responding to assessed risks
 - Determine whether sufficient appropriate audit evidence concerning the relevant financial statement assertions is available **from records held at the user entity**
 - If not, then **perform further audit procedures** to obtain sufficient appropriate audit evidence or **use another auditor** to perform those procedures at the service organization on the user auditor's behalf

Tests of Controls

- When the user auditor's risk assessment includes **an expectation that controls at the service organization are operating effectively**, the auditor must obtain audit evidence about the operating effectiveness of those controls from one or more of the following three procedures:
 - 1) Obtaining a **type 2 report**, if available;
 - the user auditor must determine whether the service auditor's report provides sufficient appropriate audit evidence by:
 - a) Evaluating whether the description, design and operating effectiveness of controls at the service organization is at a date or for a period that is appropriate
 - b) Determining whether complementary user entity controls identified by the service organization are relevant to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;
 - c) Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
 - d) Evaluating whether the tests of controls performed by the service auditor and the results thereof, described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.
 - 2) Performing appropriate tests of controls at the service organization; or
 - 3) Using another auditor to perform tests of controls at the service organization