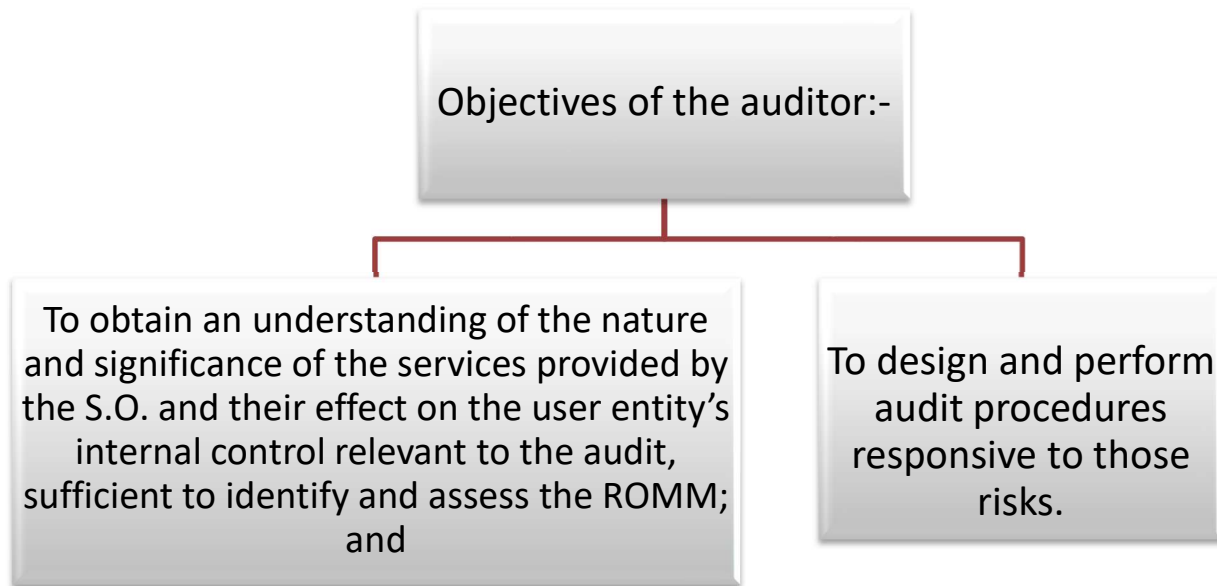


SA 402: - Audit Consideration Relating to an entity using service of Service Organization (S.O.)

(Deals with user auditor's responsibility to obtain SAAE when a user entity uses services of one or more service organization.)

OBJECTIVES OF AUDITOR: -



DEFINITION: -

Service Organization	A <u>third-party organization</u> that <u>provides service to user entities</u> that are <u>part of those entities information system relevant to financial reporting.</u>	
User Entity	<u>An entity uses a service organization</u> and <u>whose FS are being audited.</u>	
Service Auditor	An auditor who at the <u>request of service organization</u> <u>provide assurance report on the control of service organization.</u>	
User Auditor	An <u>auditor who audits and report on the FS of user entity.</u>	
Type 1 Report	A description, prepared by management of the S.O., of	A report by the service auditor with the objective

	<p>the service organisation's</p> <ul style="list-style-type: none"> • system, • control objectives and • related controls <p>that have been designed and implemented as at a specified date; and</p>	<p>of <u>conveying reasonable assurance</u> that includes;</p> <p>Service auditor opinion on the description of the service organisation's</p> <ul style="list-style-type: none"> • system, • control objectives and • related controls <p>and the suitability of the design of control to achieve the specified objectives.</p>
Type 2 Report	<p>A description, prepared by management of the S.O., of the service organisation's</p> <ul style="list-style-type: none"> • system, • control objectives and • related controls <p>that have been designed and implemented as at a specified date or throughout a specified period, and in some cases, their operating effectiveness throughout a specified period.</p>	<p>A report by the service auditor with the objective of <u>conveying reasonable assurance</u> that includes;</p> <ol style="list-style-type: none"> a. Service auditor opinion on the description of the service organisation's <ul style="list-style-type: none"> • system, • control objectives and • related controls <p>and the suitability of the design of control to achieve the specified objectives, and the operating effectiveness of the controls, and</p> b. A description of the service auditor's tests of the controls and the results thereof.

WHEN SERVICES PROVIDED BY A S.O. ARE RELEVANT TO THE AUDIT OF USER ENTITY'S FS: -

1. The **classes of transaction** in the entity's operation that are significant to the user entity's FS.

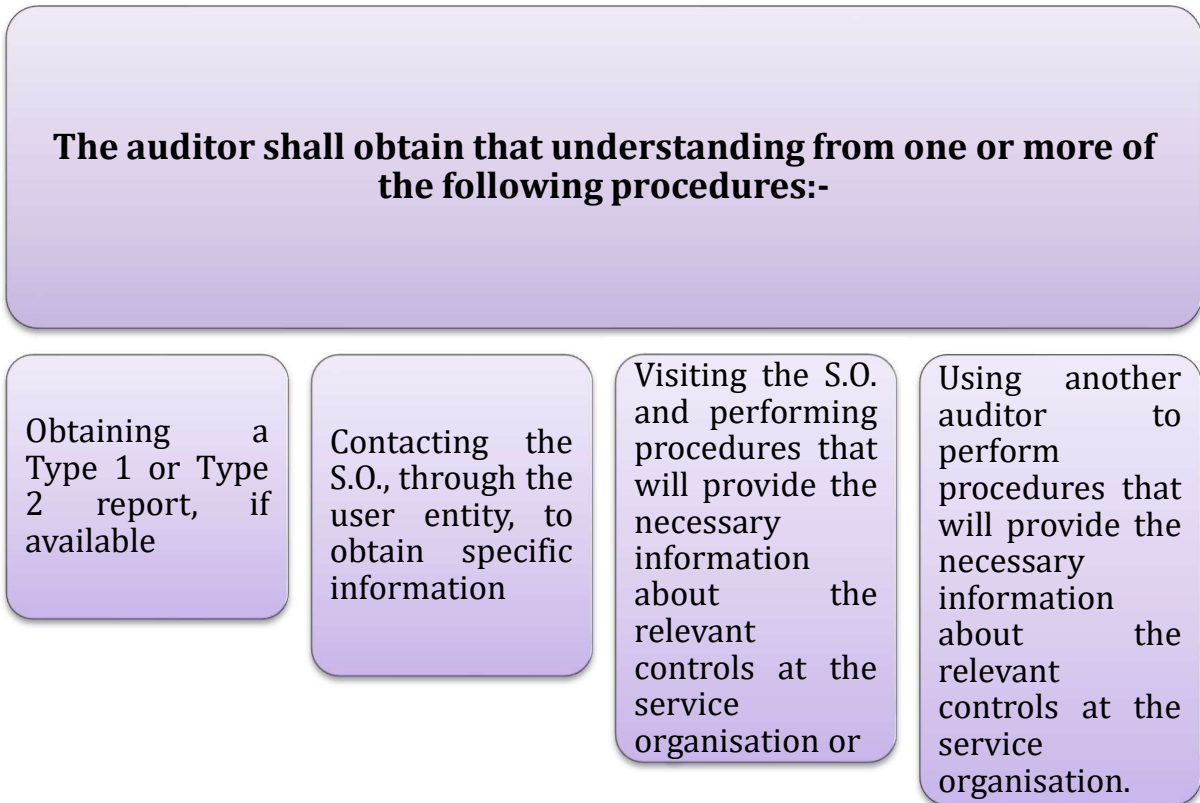
2. How the *user entity's information system captures event and conditions* other than transaction that are significant to the FS.
3. *Procedures* by which the *user entity's transactions are initiated, recorded, processed and reported in the FS.*
4. *Financial reporting process used to prepare the user entity's FS* including significant accounting estimates and disclosures.
5. *Control surrounding journal entries*, including *non-standard journal entries* used to *record non-recurring, unusual transactions or adjustments.*

OBTAINING AN UNDERSTANDING OF THE SERVICES PROVIDED BY S.O.

1. When obtaining an understanding of the user entity as per SA 315, the user auditor shall obtain an understanding of how a user entity uses the service of a S.O. in the user entity's operations, including: -
 - a. The *nature and significance* of service provided by S.O.
 - b. The *nature and materiality* of the *transaction processed or accounts or financial reporting processes* affected by the S.O.
 - c. The *degree of interaction* between the activities of the S.O. and those of the user entity.
 - d. The *nature of the relationship* between them including contractual terms.
2. When obtaining an understanding of internal control relevant to the audit in accordance with SA 315, the user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the S.O.
3. The user auditor shall determine whether a sufficient understanding of the nature and significance of the services provided by the S.O. 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 ROMM.

IF USER AUDITOR UNABLE TO OBTAIN A SUFFICIENT UNDERSTANDING FROM THE USER'S ENTITY



USING TYPE 1 AND TYPE 2 REPORT

In determining the SAAE provided by a Type 1 or Type 2 report, the user auditor shall be satisfied about: -

- a. **Service auditor's professional competence** (except where the service auditor is a member of the ICAI) and **independence** from the S.O.; and
- b. **Adequacy of the standards** under which the Type 1 or Type 2 report was issued.

If the user auditor plans to use a Type 1 or Type 2 report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the S.O.,

The user auditor shall:

- a. Evaluate whether the **description and design of controls at the S.O.**

is at a date or for a period that is appropriate for the user auditor's purposes;

- b. 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; and
- c. Determine whether complementary user entity controls identified by S.O. 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 in accordance with SA 330, the user auditor shall: -

- a. Determine whether SAAE concerning the relevant FS assertions is available from records held at the user entity; and, if not,
- b. Perform further audit procedures to obtain SAAE or use another auditor to perform those procedures at the S.O. on the behalf of user auditor.

TESTS OF CONTROLS

When user auditor's risk assessment include expectation that controls at the S.O. are operating effectively, then the user auditor shall obtain audit evidence about the operating effectiveness of those controls through: -

- a. Obtaining a Type 2 report, if available
- b. Performing appropriate tests of controls at the S.O. or
- c. Using another auditor to perform tests of controls at the S.O. on the behalf of user auditor.

Using a Type 2 report as audit evidence that controls at the S.O. are operating effectively

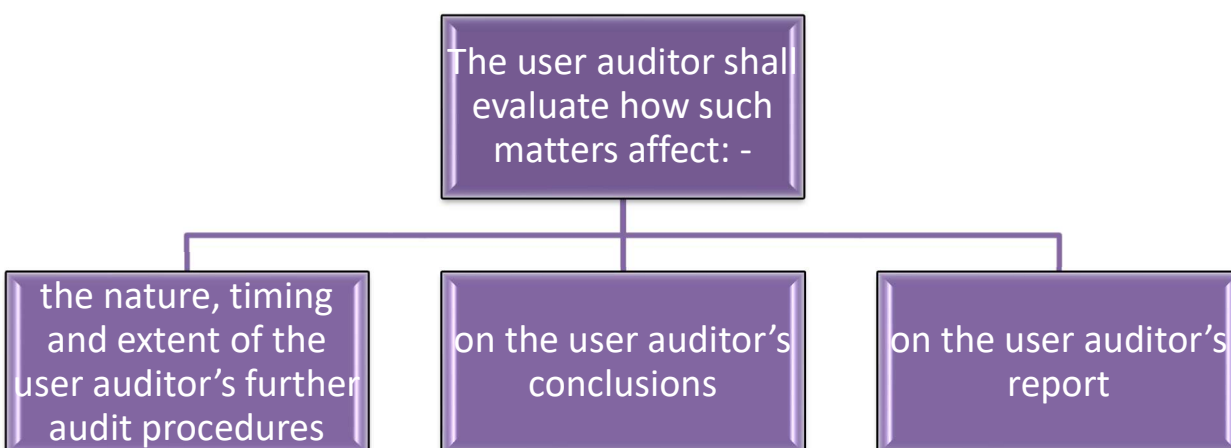
User auditor shall determine whether the service auditor's report provides

SAAE about the effectiveness of the controls to support the user auditor's risk assessment by:

- a. Evaluating whether the description, design and operating effectiveness of controls at the S.O. is at a date or for a period that is appropriate for the user auditor's purposes;
- b. Determining whether complementary user entity controls identified by the S.O. are relevant to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such control and, if so, testing their operating effectiveness;
- c. Evaluating the adequacy of the time period covered by the tests of controls & time lapsed since performance of tests of controls, and
- d. Evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's FS and provide SAAE to support the user auditor's risk assessment.

FRAUD, NON-COMPLIANCE WITH LAWS AND REGULATIONS AND UNCORRECTED MISSTATEMENTS IN RELATION TO ACTIVITIES AT THE S.O.

User auditor shall inquire to management of the user entity whether the S.O. has reported, or otherwise aware of any fraud, non-compliance with laws and regulations or uncorrected misstatements affecting the FS of the user entity.



REPORTING BY USER AUDITOR: -

- User auditor **shall modify the opinion** in the **user auditor's report** in accordance with **SA 705**. If the user auditor is **unable to obtain SAAE regarding the services provided by the S.O.** relevant to the audit of the user entity's FS.
- If **reference to work of service auditor is relevant** to an **understanding of a modification to the user auditor's opinion**, the **user auditor's report** shall **indicate that the reference does not diminish** the **user auditor's responsibility for the audit opinion**.
- **User auditor shall not refer to the work of a service auditor** in the **user auditor's report containing an unmodified opinion unless required by law or regulation**. If such **reference is required by law or regulation**, the user auditor's report shall **indicate that the reference does not diminish** the **user auditor's responsibility for the audit opinion**.

INFORMATION W.R.T CONTROLS AT SUB-SERVICE ORGANIZATION: -

- If service organisation uses subservice organisation, the **service auditor's report may either include or exclude the subservice organisation relevant control objectives** and **related controls in the S.O.** description of its system and in the scope of the service auditor's engagement.
- These **two methods of reporting** are known as the **inclusive method** and the **carve-out method**, respectively.
- If **Type 1 or Type 2 report excludes the controls at subservice organisation**, and the **services are relevant to the audit of the user entity's FS**, the **user auditor is required to apply the requirements of this SA 402 in respect of the subservice organisation**.
- The **nature and extent of work to be performed** regarding the services provided by a subservice organisation **depend on the nature and significance of those services to the user entity** and **relevance to the audit**.