SA 402: Audit Considerations related to Entity using a Service Organisation

payroll
Accounting

Service affects F.R.
↓
Relevant to Audit

(Client) Mentor Graphics — ICs. ✓
[User Entity]

DKM Solutions — ICs ✓
Service organisation (S.O.)

Securing guards
F.R. process
Auditor

SA 402

I. Service relevant to FR? → II. Understand services → III. Take Type 1 or 2 Reports to support understanding
↓
V. Reporting. ← IV. Test of controls.

Q How to know if SO's services are relevant to User Entity's financial reporting process?

SO's services are relevant to User Entity's F.R.P., if services affect any of following:
[Trans^n → JE → Ledger → TB → FS. → Adj.]

Trans^n → ① SCoTs: Significant class of Trans^n Eg Revenue / Purchases.
→ ② How info. system captures trans^n other than SCoTs.

③ Procedures [Manual / Automated) In which Trans^n are initiated, recorded, processed,
④ A/c Records rectified, trfd. to G.L. & reported in FS.

⑤ Financial Reporting Process to prepare FS.

⑥ Controls surrounding JEs including non-standard JEs. i.e. – Non-Recurring, – Unusual – Adjustment Entries.
NUA

Obtaining understanding of services of S.O.

a) Nature & significance of service to user entity.

Can obtain info. from contract, user manuals, reports of service auditor (jarud w) etc.

b) Nature & materiality of transⁿ processed by S.O.

Eg. Payroll A/c service [significant] ⟶ (Tranⁿ) Employee benefit exp. (material).

c) Degree of interaction b/w User Entity & S.O. Activities.

User Entity [Authorise] —Data→ S.O.

S.O. —Accounting→ User Entity

d) Nature of relationship b/w user entity & S.O. including contractual terms.

Understanding?
- User entity
- or
- contact S.O. through user entity.
- visit S.O.
- using another auditor to perform procedures
- obtain Type 1 or 2 Report

User Entity

S.O
- payroll Accounting Service
  ↓
  TCs Report?
  By Service Auditor

2 Types of Reports.

Type 1	Type 2
• SO's description of system.	• SO's description of system.
• written assertion by S.O.: S.O.'s system described fairly. Controls related to control objectives are suitably designed — at a specified date.	• written assertion by S.O.: S.O.'s system described fairly. Controls related to control objectives are suitably designed. controls operated effectively. — throughout specified period.
• Service Auditor's Assurance Report giving Reasonable assurance, on above matters.	• Service Auditor's Assurance Report giving Reasonable assurance, on above matters. + Description (TOCs + Results).

Using a Type 1 or 2 Report

→ Support user auditor's understanding of S.O.

Be satisfied about
- ① Service Auditor's ← professional competence [Except if CA.] ; Independence for S.O.
- & Adequacy of standards under which Type 1 or 2 report issued. (SAE 3402)

User auditor shall evaluate:
- Description & design of controls at S.O. [at a date / appt. period]. (Type 1 / Type 2)
- SAAE obtained by report for user entity's controls relevant for audit.
- Complementary user entity's controls identified by SO?
  ↓ (yes)
  Understand if user entity designed & implemented such controls.

Payroll Process

eg

Normal
I. User Entity Controls
Authorise
- New Joiner.
- Salary / compensation.
- Increment
- Leave the Co.

(Accounting)
II. S.O.
- Monthly salary calculation
- Deduction
  - EPF / ESI
  - TDS.

(Supporting)
III. Complementary U.E controls.
- Review payroll registers & communicate errors.

TOCs karte kyu?

A. Procedure
- R.A.P. [Understanding → Romm?] 10%
  [IR × CR] — IR 40%, CR 25%
  ① Expectation controls are 75% effective.
- (F.A.P)
  - TOCs. ✓
  - Subs. Pro. ② enough

⇒ Expectation ⇒ controls at S.O. are effective. ⇒ TOCs
- Type 2 Report
  or
- Perform
  or
- Another Auditor.

Using Type 2 Report to obtain Evidence for operating effectiveness of controls

Aspects consider?

Evaluate
- Description, design & operating effectiveness of controls at.
  ① S.O.
  ② Complementary U.E controls.
- Adequacy of time period (covered & elapsed since TOCs.)
- Whether TOCs & results provide SAAE.

Services (Check)

User Entity ← S.O. SA402

S.O. ↑ Service — payroll A/C

S.S.O SA402

Sub-service org.

Service Auditor → Type 1 or 2 Report → Controls → S.O.

↓

S.S.O

Include (Balle Balle). or Exclude (carve-out method)

Inclusive method.

SA402

- contact
- visit
- Another Audit
- SSO Type 1/2 report

SA402 : Audit considerations for User Entity using a S.O.

1. SO services relevant to user entity's FR process

- Transⁿ — SCOTS
  - How info. system captures NSCOTS
- Procedures } manual / automated
- A/c Records } manual / automated
- F.R.P (Prepare FS)
- Non std JEs (NOA)

2. Understanding Nature & Extent of Services of SO.

- Nature & significance of services
- Nature & materiality of Transⁿ
- Degree of interaction
- Nature of Relationship

3. Understanding → How?

- User entity $\xrightarrow{\times}$ contact SO / visit / another auditor / Type 1/2 Report.

Type 1 Report ⇒ Description of system + SO's Assertion (fair description + controls designed) → Date. + R.A. Report

Type 2 Report ⇒ Description of system + SO's assertion (fair description + controls designed + op effect.) + R.A. (+ TOCs & Results) throughout period.

⇒ Using Type 1/2 Reports to support understanding of SO.

Be satisfied [S Service Auditor (competence, Independence, Stds.)] + Evaluate
- D&D of S.O. controls — Date / period.
- UE controls → SAAE?
- Comp. UE controls identified
  - ↳ D & Impelement?

4. TOCs (kyu?) ⇒ Expectation controls operating effectively

↓

S.O. [Type 2 / Test / Other auditor]

5. $\boxed{\text{Type 2}}$ Report → SAAE for op. effectiveness of controls → Aspects?

Description, design & op. effectiveness of controls
- SO
- Comp. UE controls

+ Period (covered / elapsed) + TOCs & Results (SAAE?)

6. Fraud, NOCLAR, uncorrected misst. at S.O. → Inquire! → NTE of FAP + Reporting / comcⁿ

7. A. Report → unmodified opinion → Refer ✗

↓

modified opinion (Relevant) ⟶ Refer ✓