



Reporting on Controls at a Service Organization

March 2010

**COMMENTS MUST BE RECEIVED BY
MAY 6, 2010**

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Individuals and organizations are invited to comment on the Exposure Draft material. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs, and, when expressing disagreement with the Exposure Draft, they clearly explain the problem, and include a suggestion for alternative wording supported by specific reasoning. All comments received will

be available on the web site at www.aasb.ca 10 days after the comment deadline, unless confidentiality is requested.

**To be considered, comments must be received by
May 6, 2010, addressed to:**

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For ease of handling, we prefer comments to be sent by
e-mail (in Word format), to:
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Highlights

The Auditing and Assurance Standards Board (AASB) proposes, subject to comments received following exposure, to issue a new Canadian Standard on Assurance Engagements (CSAE), “Reporting on Controls at a Service Organization,” in the CICA Handbook – Assurance (Handbook). This standard will replace:

- AUDITOR’S REPORT ON CONTROLS AT A SERVICE ORGANIZATION, Section 5970; and
- former AuG-42, Service Organizations that Use Other Service Organizations.

The proposed CSAE is designed to provide standards and guidance to a practitioner who is reporting on controls at a service organization that provides a service to user entities and those controls are likely to be relevant to user entities’ internal control over financial reporting. It complements Canadian Auditing Standard (CAS) 402, “Audit Considerations Relating to an Entity Using a Service Organization,” in that reports prepared in accordance with this proposed CSAE may provide appropriate evidence under CAS 402.

Background

The AASB decided to develop this new CSAE in response to changes in relevant assurance standards in both the United States and internationally. The proposed CSAE is aligned with a new Statement on Standards for Attestation Engagements (SSAE), *Reporting on Controls at a Service Organization*,¹ which is expected to be issued by the American Institute of Certified Public Accountants’ (AICPA) Auditing Standards Board (ASB). The new SSAE will supersede Statement on Auditing Standard No. 70, *Service Organizations* (SAS 70). The AASB decided not to adopt the new International Standard on Assurance Engagements (ISAE) 3402, “Assurance Reports at a Service Organization,” recently issued by the International Auditing and Assurance Standards Board (IAASB). Key matters that the AASB considered in making this decision are set out below:

- In February 2008, the AASB obtained input from stakeholders who expressed a strong desire to align any new Canadian standard on audit of controls at a service organization with the corresponding US standard. They noted that the Canadian and US markets for these types of engagements are highly integrated. Both Section 5970 and SAS 70 are extensively used in Canada and, therefore, these standards are closely aligned.
- The AASB is committed to adopting the International Standards on Auditing (ISAs) but it has not decided to adopt, as a whole, other international standards dealing with assurance and related services engagements.
- The AASB has adopted ISA 402, “Audit Considerations Relating to an Entity Using a Service Organization,” as CAS 402. Like ISA 402, CAS 402 does not require a user entity auditor to use a service auditor’s report that has been prepared under ISAE 3402. Service auditor’s reports prepared under other recognized national standards (for example, Section 5970, the new SSAE or the AASB’s proposed CSAE) are acceptable.
- By aligning with the new SSAE, the proposed CSAE would also align with ISAE 3402 in most respects. The AICPA’s ASB has identified only five substantive differences between ISAE 3402 and the new SSAE. These also represent the expected differences between ISAE 3402 and the proposed CSAE. These differences are set out below.

¹ As presented to the AICPA’s ASB in its January 2010 meeting.

1. Intentional acts by service organization personnel
The new SSAE includes a requirement that if the service auditor determines that any identified deviation has resulted from intentional act(s) by the service organization personnel, the service auditor should assess the risk that the description is not fairly presented, the controls are not suitably designed, and in a type 2 engagement, controls are not operating effectively. ISAE 3402 does not have this requirement.
2. Subsequent events
The new SSAE requires the service auditor to disclose in the service auditor's report, any event that is of such a nature and significance that its disclosure is necessary to prevent users from being misled, if not disclosed by management in its description. ISAE 3402 limits the subsequent events that would need disclosure to those that could have a significant effect on the service auditor's report.

The new SSAE also requires the service auditor to adapt and apply the guidance in the AICPA's auditing standard related to subsequent events, if after the release of the service auditor's report, the service auditor becomes aware of conditions that existed at the report date that might have affected management's assertion and the service auditor's report had the service auditor been aware of them. ISAE 3402 does not have a similar requirement.
3. Statement restricting use of the service auditor's report
The new SSAE requires wording in the service auditor's report that restricts the use of the report to management of the service organization, user entities of the service organization's system during some or all of the period covered by the service auditor's report and user auditors. ISAE 3402 does not require, but does not prohibit, the inclusion of language to specifically restrict use and distribution of the report.
4. Direct assistance
The new SSAE permits the service auditor to use the work of the internal audit function to provide direct assistance. ISAE 3402 does not provide for use of the internal audit function for direct assistance in carrying out procedures.
5. Anomalies
ISAE 3402 contains a requirement regarding actions to take in the extremely rare circumstance when the service auditor considers a deviation in a sample to be an anomaly. The requirement is taken directly from ISA 530, "Audit Sampling." The new SSAE does not have this requirement.

The AICPA's ASB is proposing to delete this requirement when it converges its proposed SAS, *Auditing Sampling* with ISA 530 as it believes that all deviations identified in tests of controls involving sampling should be treated in the same manner.

Main features of the proposed CSAE

Drafting conventions

As with all new or revised standards issued by the AASB, the proposed CSAE has been drafted using the clarity format. Therefore, it includes subsections dealing with objectives, requirements and application and other explanatory material.

Aligning with the new SSAE

As noted above, the proposed CSAE has been drafted using the new SSAE as its base. Because of the importance to the Canadian stakeholders that the new SSAE and the proposed CSAE be closely aligned, the AASB has made only those minimal changes to the new SSAE considered necessary to ensure the proposed CSAE is appropriate for use in Canada. These changes relate to the following matters:

- terminology, cross-referencing and formatting conventions as used in the CICA Handbook – Assurance; and
- ensuring the proposed CSAE is consistent with the existing Other Canadian Standards.²

The following is a summary of the significant changes made to the new SSAE in order for the proposed CSAE to be appropriate for use in Canada:

1. Framework

The new SSAE is based on AT section 101, *Attest Engagements*, which is the framework standard that covers all attestation engagements. The new SSAE contains a number of references to and content from AT 101. In Canada, STANDARDS FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION, Section 5025, establishes the framework and includes recommendations for all assurance engagements, other than audits of financial statements and other historical financial information. Therefore, in developing the proposed CSAE, this material has been replaced with references to and content that is consistent with Section 5025.

2 Cross-references to auditing standards

The AASB determined that this proposed CSAE will not contain references to Canadian Auditing Standards (CASs). The AASB believes that a practitioner performing this assurance engagement should not be expected to be proficient in adapting and applying the CASs in order to meet the requirements of this assurance engagement standard. A similar position was taken by the IAASB in its development of ISAE 3402. However, the AICPA, in its new SSAE, elected to refer directly to auditing standards in its requirements rather than include the relevant material within the new SSAE.

When the new SSAE contains references to an auditing standard in a requirement, the proposed CSAE has replaced the reference with the corresponding relevant material extracted from ISAE 3402 with the following exceptions:

Direct assistance:

The new SSAE's requirement to adapt and apply the requirements in AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, when the service auditor uses members of the internal audit function to provide direct assistance has been replaced with the relevant recommendation in USING THE WORK OF INTERNAL AUDIT IN ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION, Section 5050. Currently ISAE 3402 does not permit direct assistance, whereas Section 5050 does. Material in this case was extracted from Section 5050 in order for the proposed CSAE to be consistent with Other Canadian Standards.

² Refer to the Preface in the CICA Handbook – Assurance for a discussion of “Other Canadian Standards.”

Subsequent events:

The new SSAE requires the service auditor to adapt and apply the requirements in AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, if the service auditor becomes aware of certain facts after the service auditor's report is issued. As discussed above, ISAE 3402 does not contain a similar requirement. The reference to AU 561 has been replaced with a requirement to respond appropriately to such facts. The AASB determined that guidance would be desirable, but a requirement to obtain this guidance from CAS 560, "Subsequent Events," would not be appropriate, for the reasons stated above. In only this instance, the AASB refers the service auditor to consider the guidance in CAS 560. The cross-reference does not appear in the requirements but is provided in the application material.

Other Changes

The AASB plans to amend the proposed CSAE, before the final standard is issued, to reflect the following:

- amendments, as determined by the AICPA's ASB, in approving the new SSAE as a final standard; and
- changes proposed in the AASB Exposure Draft "Dating of the Practitioner's Report for Review and Other Assurance Engagements." That Exposure Draft proposes to eliminate inconsistencies, considered to be urgent, between assurance standards and the CASs.

Key differences between the proposed CSAE and current Canadian standards

Section 5970 provides guidance to practitioners who issue service audit reports on processing transactions by a service organization for use by user entities and their auditors. AuG-42 supplemented Section 5970 by discussing situations in which a service organization uses another service organization (a subservice organization) to perform some or all of the processing of user entities' transactions. The proposed CSAE covers the same subject matter, but there are some significant differences between the proposed CSAE and the current Canadian standards. What is significant to a user will depend on the particular circumstances. Therefore, practitioners should perform their own review of the entire proposed CSAE and other relevant materials to understand how its proposals would require changes to their current practices, policies or methodologies. Differences that may be considered significant are listed below.

1. Self-standing nature of the proposed CSAE

The proposed CSAE is a self-standing standard. That is, rather than referring to other standards such as CASs that deal with various matters, the proposed CSAE itself provides requirements and application material on those matters in the context of an engagement to report on controls at a service organization. (The only exception is the reference to CAS 560 in application material as discussed above.) Such matters include:

- assessing the suitability of criteria;
- setting materiality and assessing engagement risk;
- using the internal audit function;
- sampling;
- documentation; and
- other information.

Section 5970, on the other hand, is not self-standing. It does not cover all matters and it makes references to other auditing and assurance standards.

2. Assertion-based engagement

The proposed CSAE deals only with assertion-based engagements. It requires the service organization management to provide an assertion that is included in or attached to the service organization's description of its system. This assertion addresses matters including the fair presentation of the description of the service organization's system, the suitable design of controls related to the organization's control objectives and, in the case of a type 2 report, the effective operation of such controls.

Management's refusal to provide a written assertion represents a scope limitation and results in a withdrawal from the engagement or a disclaimer of opinion when a law or regulation does not permit withdrawal.

The proposed CSAE also states that if the written assertion is not provided, the service auditor cannot circumvent this requirement by performing the engagement under Section 5025.

Section 5970 does not have similar requirements.

3. Suitable criteria

The proposed CSAE contains requirements on assessing the suitability of the criteria used in preparing and presenting the description of the system, in evaluating whether controls are suitably designed and, in the case of a type 2 report, in evaluating whether controls are operating effectively. It sets out the minimum elements of suitable criteria for these engagements. Section 5970 does not explicitly deal with matters related to suitable criteria.

4. Intentional acts by service organization personnel

Section 5970 does not deal with the concept of "intentional acts". It does not provide a requirement regarding follow-up action for the service auditor when he or she obtains information about intentional acts as a result of the investigation of the nature and cause of any deviations identified as does the proposed CSAE.

5. Subservice organizations

The proposed CSAE contains requirements and related application material on this topic. This topic was covered more comprehensively in AuG-42.

6. Period of time vs. point in time reporting for the type 2 report

The proposed CSAE requires the service auditor's work and report to cover, for the entire period under audit, the presentation of description of the system, the suitable design of controls and the effective operation of controls. Under Section 5970, the service auditor's work and report on the presentation of description of the systems and the suitable design of control is "as at" a specified date, rather than covering the entire period under audit.

7. Statement restricting use of the service auditor's report

The proposed CSAE requires wording in the report that restricts the use of the service auditor's report. A report issued under Section 5970 contains a statement of restrictions, if any, placed on its distribution.

8. Nature and extent of information provided on work performed by others

The proposed CSAE discusses using the work of an internal audit function and does not address using the work of specialists or others. It requires that the service auditor make no reference in his or her opinion to the work done by the internal audit function. However, the service auditor is required to include, in that part of his or her report that describes tests of controls and the results thereof, a description of the work done by the internal audit function and the service auditor's procedures with respect to that work.

Section 5970 addresses using the work of others, including internal audit and specialists, and requires that the service auditor make no reference in his or her report to the work of others, nor attribute the performance of the tests or results of the tests to them.

Effective date

The effective date of the proposed CSAE, if approved, would be for service auditors' reports for periods ending on or after December 15, 2011. Earlier implementation will be permitted.

The effective date for the new SSAE (and ISAE 3402) is for periods ending on or after June 15, 2011 with earlier implementation permitted.

The AASB acknowledges that if the effective dates were aligned for periods ending on or after June 15, 2011 (i.e., when SAS 70 and Section 5970 are no longer effective), there may not be sufficient time for Canadian practitioners to transition to the CSAE. On the other hand, the amount of time that Section 5970 reports would be issued in the marketplace but no further SAS 70 reports would be permitted, should be minimal. During the extended timeframe, any reports issued under Section 5970 will not be aligned with reports in the US that will be required to be issued under the new SSAE and not SAS 70. Therefore, the AASB is proposing a short extended period in which a practitioner may choose to use either Section 5970 or the proposed CSAE. Section 5970 will then no longer be effective for service auditors' reports for periods ending on or after December 15, 2011.

The AASB proposes that early implementation should be permitted to ensure practitioners in Canada have access to a standard as close as practically possible to when the practitioners in the US may begin to use the new SSAE.

With earlier implementation permitted, both the proposed CSAE and Section 5970 will be effective and will reside in the CICA Handbook – Assurance at the same time. In order to assist the practitioner in determining his or her options, Section 5970 will contain a link that refers a practitioner to the CSAE.

Comments requested

The AASB welcomes comments on the following questions:

1. In light of the AASB's objective to align the Canadian assurance standard for this type of engagement with the AICPA ASB's new SSAE, stakeholders are asked to restrict their comments to those that identify unique Canadian issues with respect to the proposed requirements that would warrant a modification to the wording. Do you believe a modification is needed? If so, please describe its nature and extent.
2. Do you agree with the proposed effective date? If not, please provide an explanation including what you would propose.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs, and, when expressing disagreement with the Exposure Draft, they clearly explain the problem, and include a suggestion for alternative wording supported by specific reasoning. When a respondent agrees with proposals in the Exposure Draft, it will be helpful for the AASB to be made aware of this view.

Proposed Canadian Standard on Assurance Engagements (CSAE) Reporting on Controls at a Service Organization

(Effective for service auditor's reports for periods ending on or after December 15, 2011)

CONTENTS

	Paragraph
Introduction	
Scope of this Canadian Standard on Assurance Engagements	1-4
Effective Date	5
Objectives	6
Definitions	7
Requirements	
Management and Those Charged With Governance	8
Acceptance and Continuance	9-12
Assessing the Suitability of the Criteria	13-16
Materiality	17
Obtaining an Understanding of the Service Organization's System	18
Obtaining Evidence Regarding Management's Description of the Service Organization's System	19-20
Obtaining Evidence Regarding the Design of Controls	21
Obtaining Evidence Regarding the Operating Effectiveness of Controls	22-27
Using the Work of an Internal Audit Function	28-35
Written Representations	36-39
Other Information	40-41
Subsequent Events	42-43
Documentation	44-51
Preparing the Service Auditor's Report	52-57
Other Communication Responsibilities	58

Application and Other Explanatory Material

Scope of this Canadian Standard on Assurance Engagements A1-A4

Definitions..... A5-A11

Management and Those Charged With Governance A12

Acceptance and Continuance A13-A21

Assessing the Suitability of the Criteria..... A22-A24

Materiality..... A25-A27

Obtaining an Understanding of the Service Organization’s System A28-A30

Obtaining Evidence Regarding Management’s Description of the
Service Organization’s System A31-A35

Obtaining Evidence Regarding the Design of Controls A36-A39

Obtaining Evidence Regarding the Operating Effectiveness of Controls A40-A47

Using the Work of an Internal Audit Function..... A48-A53

Written Representations..... A54-A58

Other Information A59-A61

Subsequent Events A62

Documentation A63-A64

Preparing the Service Auditor’s Report..... A65-A71

Other Communication Responsibilities A72

Appendix 1: Illustrative Service Auditor’s Reports

Appendix 2: Illustrative Modified Service Auditor’s Reports

Appendix 3: Illustrative Report Paragraphs for Service Organizations That Use a
Subservice Organization

Appendix 4: Illustrative Assertions by Management of the Service Organization

Canadian Standard on Assurance Engagements (CSAE), “Reporting on Controls at a Service Organization” should be read in conjunction with the “Preface to the CICA Handbook – Assurance.”

Introduction

Scope of this Canadian Standard on Assurance Engagements

1. This Canadian Standard on Assurance Engagements (CSAE) addresses audit engagements undertaken by a service auditor to report on controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities’ internal control over financial reporting. It complements CAS 402,¹ in that reports prepared in accordance with this CSAE may provide appropriate evidence under CAS 402. (Ref: Para. A1)
2. The focus of this CSAE is on controls at service organizations likely to be relevant to user entities’ internal control over financial reporting. The guidance herein also may be helpful to a practitioner performing an engagement under Section 5025,² to report on controls at a service organization:
 - (a) Other than those that are likely to be relevant to user entities’ internal control over financial reporting, for example, controls that affect user entities’ compliance with specified requirements of laws, regulations, rules, contracts, or grants, or controls that affect user entities’ production, or quality control; or (Ref: Para. A2-A3)
 - (b) Where management of the service organization is not responsible for the design of the system (for example, when the system has been designed by the user entity or the design is stipulated in a contract between the user entity and the service organization.) (Ref: Para. A4)
3. In addition to performing an audit of a service organization’s controls, a service auditor may be engaged to:
 - (a) Audit and report on a user entity’s transactions or balances maintained by a service organization; or
 - (b) Perform and report the results of agreed upon procedures related to the controls of a service organization or to transactions or balances of a user entity maintained by a service organization.

However, these engagements are not addressed in this CSAE.

4. The requirements and application material in this CSAE are based on the premise that management of the service organization (also referred to as management) will provide the service auditor with a written assertion that is included in or attached to management’s description of the service organization’s system, Paragraph 10 of this CSAE addresses the circumstances in which management refuses to provide such a written assertion. Section 5025 indicates that when performing an attest engagement, a practitioner may report directly on the subject matter or on management’s assertion. For engagements conducted under this CSAE, the service auditor is required to report directly on the subject matter.

¹ CAS 402, “Audit Considerations Relating to an Entity Using a Service Organization.”

² STANDARDS FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION, Section 5025.

Effective Date

5. This CSAE is effective for service auditors' reports for periods ending on or after December 15, 2011. Earlier implementation is permitted.

Objectives

6. The objectives of the service auditor are to:
 - (a) Obtain reasonable assurance about whether, in all material respects, based on suitable criteria:
 - (i) Management's description of the service organization's system fairly presents the system that was designed and implemented throughout the specified period (or in the case of a type 1 report, as of a specified date);
 - (ii) The controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period (or in the case of a type 1 report, as of a specified date);
 - (iii) When included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved throughout the specified period.
 - (b) Report on the matters in (a) above in accordance with the service auditor's findings.

Definitions

7. For purposes of this CSAE, the following terms have the meanings attributed in the subsequent text:
 - (a) Carve-out method – Method of addressing the services provided by a subservice organization whereby management's description of the service organization's system identifies the nature of the services performed by the subservice organization and excludes from the description and from the scope of the service auditor's engagement, the subservice organization's relevant control objectives and related controls. Management's description of the service organization's system and the scope of the service auditor's engagement include controls at the service organization that monitor the effectiveness of controls at the subservice organization, which may include management of service organization's review of a service auditor's report on controls at the subservice organization.
 - (b) Complementary user entity controls – Controls that management of the service organization assumes, in the design of the service provided by the service organization, will be implemented by user entities, and which, if necessary to achieve the control objectives stated in management's description of the service organization's system, are identified as such in that description.
 - (c) Control objectives – The aim or purpose of specified controls at the service organization. Control objectives address the risks that controls are intended to mitigate.

- (d) Controls at a service organization – The policies and procedures at a service organization likely to be relevant to user entities’ internal control over financial reporting. These policies and procedures are designed, implemented, and documented by the service organization to provide reasonable assurance about the achievement of the control objectives relevant to the services covered by the service auditor’s report. (Ref: Para. A5)
- (e) Controls at a subservice organization – The policies and procedures at a subservice organization likely to be relevant to internal control over financial reporting of user entities of the service organization. These policies and procedures are designed, implemented, and documented by a subservice organization to provide reasonable assurance about the achievement of control objectives that are relevant to the services covered by the service auditor’s report.
- (f) Criteria – The standards or benchmarks used to measure and present the subject matter and against which the service auditor evaluates the subject matter. (Ref: Para. A6)
- (g) Inclusive method – Method of addressing the services provided by a subservice organization whereby management’s description of the service organization’s system includes a description of the nature of the services provided by the subservice organization as well as the subservice organization’s relevant control objectives and related controls. (Ref: Para. A7–A9)
- (h) Internal audit function – The service organization’s internal auditors and others, for example, members of a compliance or risk department, who perform activities similar to those performed by internal auditors. (Ref: Para. A10)
- (i) Report on management’s description of a service organization’s system and the suitability of the design of controls (referred to in this CSAE as a *type 1 report*) – A report that comprises:
 - (i) Management’s description of the service organization’s system;
 - (ii) A written assertion by management about whether, in all material respects, and based on suitable criteria:
 - a. Management’s description of the service organization’s system fairly presents the service organization’s system that was designed and implemented as of a specified date; and
 - b. The controls related to the control objectives stated in management’s description of the service organization’s system were suitably designed to achieve those control objectives as of the specified date; and
 - (iii) A service auditor’s report that expresses an opinion on the matters in (ii) a.-b..
- (j) Report on management’s description of a service organization’s system and the suitability of the design and operating effectiveness of controls (referred to in this CSAE as a *type 2 report*) – A report that comprises:
 - (i) Management’s description of the service organization’s system;
 - (ii) A written assertion by management about whether in all material respects, and based on suitable criteria:
 - a. Management’s description of the service organization’s system fairly presents the service organization’s system that was designed and implemented throughout the specified period;

- b. The controls related to the control objectives stated in management’s description of the service organization’s system were suitably designed throughout the specified period to achieve those control objectives; and
 - c. The controls related to the control objectives stated in management’s description of the service organization’s system operated effectively throughout the specified period to achieve those control objectives.
- (iii) A service auditor’s report that:
 - a. Expresses an opinion on the matters in (ii)a.–c.; and
 - b. Includes a description of the tests of controls and the results thereof.
- (k) Service auditor – A practitioner who reports on controls at a service organization.
- (l) Service organization – An organization or segment of an organization that provides services to user entities that are likely to be relevant to those user entities’ internal control over financial reporting.
- (m) Service organization’s assertion – A written assertion about the matters referred to in part (ii) of the definition of “Report on management’s description of a service organization’s system and the suitability of the design and operating effectiveness of controls,” for a type 2 report; and, for a type 1 report, the matters referred to in part (ii) of the definition of “Report on management’s description of a service organization’s system and the suitability of the design of controls.”
- (n) Service organization’s system – The policies and procedures designed, implemented, and documented, by management of the service organization to provide user entities with the services covered by the service auditor’s report. Management’s description of the service organization’s system, identifies the services covered, the period to which the description relates (or in the case of a type 1 report, the date to which the description relates), the control objectives specified by management or an outside party, the party specifying the control objectives (if not specified by management), and the related controls. (Ref: Para. A11)
- (o) Subservice organization – A service organization used by another service organization to perform some of the services provided to user entities that are likely to be relevant to those user entities’ internal control over financial reporting.
- (p) Test of controls – A procedure designed to evaluate the operating effectiveness of controls in achieving the control objectives stated in management’s description of the service organization’s system.
- (q) User auditor – An auditor who audits and reports on the financial statements of a user entity.
- (r) User entity – An entity that uses a service organization.

Requirements

Management and Those Charged with Governance

8. Where this CSAE requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with management of the service organization, the service auditor shall determine the appropriate person(s) within the service organization's management or governance structure with whom to interact. This shall include consideration of which person(s) have the appropriate responsibilities for and knowledge of the matters concerned. (Ref: Para. A12)

Acceptance and Continuance

9. A service auditor shall accept or continue an engagement to report on controls at a service organization only if: (Ref: Para. A13)
 - (a) The service auditor has the capabilities and competence to perform the engagement; (Ref: Para. A14-A15)
 - (b) The service auditor's preliminary knowledge of the engagement circumstances indicates that:
 - (i) The criteria to be used will be suitable and available to the intended user entities and their auditors;
 - (ii) The service auditor will have access to sufficient, appropriate evidence to the extent necessary; and
 - (iii) The scope of the engagement and management's description of the service organization's system will not be so limited that they are unlikely to be useful to user entities and their auditors.
 - (c) Management agrees to the terms of the engagement by acknowledging and accepting responsibility for the following:
 - (i) Preparing its description of the service organization's system and its assertion, including the completeness, accuracy, and method of presentation of the description and assertion; (Ref: Para. A16)
 - (ii) Having a reasonable basis for its assertion; (Ref: Para. A17)
 - (iii) Selecting the criteria to be used and stating them in the assertion;
 - (iv) Specifying the control objectives, stating them in the description of the service organization's system, and, if the control objectives are specified by law, regulation, or another party (for example, a user group or a professional body), identifying in the description the party specifying the control objectives;
 - (v) Identifying the risks that threaten the achievement of the control objectives stated in the description and designing, implementing, and documenting controls that are suitably designed and operating effectively to provide reasonable assurance that the control objectives stated in the description of the service organization's system will be achieved; (Ref: Para. A18)

- (vi) Providing the service auditor with:
 - a. Access to all information, such as records and documentation, including service level agreements, of which management is aware that is relevant to the description of the service organization's system and the assertion;
 - b. Additional information that the service auditor may request from management for the purpose of the audit engagement;
 - c. Unrestricted access to personnel within the service organization from whom the service auditor determines it is necessary to obtain evidence relevant to the service auditor's engagement; and
 - d. Written representations at the conclusion of the engagement; and
 - (vii) Providing a written assertion that will be included in, or attached to management's description of the service organization's system, and provided to user entities.
10. If management will not provide the service auditor with a written assertion, the service auditor shall not circumvent the requirement to obtain an assertion by performing a service auditor's engagement under Section 5025. (Ref: Para. A19)
11. Management's subsequent refusal to provide a written assertion represents a scope limitation and consequently, the service auditor shall withdraw from the engagement. If law or regulation does not allow the service auditor to withdraw from the engagement, the service auditor shall disclaim an opinion.

Request to Change the Scope of the Engagement

12. If management requests a change in the scope of the engagement before the completion of the engagement, the service auditor shall be satisfied, before agreeing to the change, that there is reasonable justification for the change. (Ref: Para. A20-A21)

Assessing the Suitability of the Criteria

13. As required by Section 5025, the service auditor shall assess whether management has used suitable criteria:
- (a) In preparing its description of the service organization's system;
 - (b) In evaluating whether controls were suitably designed to achieve the control objectives stated in the description; and
 - (c) In the case of a type 2 report, in evaluating whether controls operated effectively throughout the specified period to achieve the control objectives stated in the description of the service organization's system. (Ref: Para. A6 and A22)
14. In assessing the suitability of the criteria to evaluate whether management's description of the service organization's system is fairly presented, the service auditor shall determine if the criteria include, at a minimum:
- (a) Whether management's description of the service organization's system presents how the service organization's system was designed and implemented, including the following information about the service organization's system, if applicable:

- (i) The types of services provided including, as appropriate, the classes of transactions processed;
 - (ii) The procedures, within both automated and manual systems, by which services are provided, including, as appropriate, procedures by which transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities;
 - (iii) The related accounting records, whether electronic or manual, and supporting information involved in initiating, authorizing, recording, processing, and reporting transactions; this includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities;
 - (iv) How the service organization's system captures and addresses significant events and conditions other than transactions;
 - (v) The process used to prepare reports and other information for user entities;
 - (vi) The specified control objectives and controls designed to achieve those objectives, including as applicable, complementary user entity controls contemplated in the design of the service organization's controls; and
 - (vii) Other aspects of the service organization's control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls that are relevant to the services provided. (Ref: Para. A17, and A23-A24)
- (b) In the case of a type 2 report, whether management's description of the service organization's system includes relevant details of changes to the service organization's system during the period covered by the description; (Ref: Para. A44) and
- (c) Whether management's description of the service organization's system does not omit or distort information relevant to the service organization's system, while acknowledging that management's description of the service organization's system is prepared to meet the common needs of a broad range of user entities and their user auditors, and may not, therefore, include every aspect of the service organization's system that each individual user entity and its user auditor may consider important in its own particular environment.
15. In assessing the suitability of the criteria to evaluate whether the controls are suitably designed, the service auditor shall determine if the criteria include, at a minimum, whether:
- (a) The risks that threaten the achievement of the control objectives stated in management's description of the service organization's system have been identified by management; and
 - (b) The controls identified in management's description of the service organization's system would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.
16. In assessing the suitability of the criteria to evaluate whether controls operated effectively to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved, the service auditor shall determine if the criteria include, at a minimum, whether the controls were consistently applied as designed, throughout the specified period, including whether manual controls were applied by individuals who have the appropriate competence and authority.

Materiality

17. When planning and performing the engagement, the service auditor shall evaluate materiality with respect to the fair presentation of management's description of the service organization's system, the suitability of the design of controls to achieve the related control objectives stated in the description and, in the case of a type 2 report, the operating effectiveness of the controls to achieve the related control objectives stated in the description. (Ref: Para. A25-A27)

Obtaining an Understanding of the Service Organization's System

18. The service auditor shall obtain an understanding of the service organization's system, including controls that are included in the scope of the engagement. (Ref: Para. A28-A30)

Obtaining Evidence Regarding Management's Description of the Service Organization's System

19. The service auditor shall obtain and read management's description of the service organization's system and shall evaluate whether those aspects of the description that are included in the scope of the engagement are presented fairly, including whether:
 - (a) The control objectives stated in management's description of the service organization's system are reasonable in the circumstances;
 - (b) Controls identified in management's description of the service organization's system were implemented;
 - (c) Complementary user entity controls, if any, are adequately described; and
 - (d) Services performed by a subservice organization, if any, are adequately described, including whether the inclusive method or the carve-out method has been used in relation to them. (Ref: Para. A31-A34)
20. The service auditor shall determine through inquiries made in combination with other procedures whether the service organization's system has been implemented. Such other procedures shall include observation and inspection of records and other documentation of the manner in which the service organization's system operates and controls are applied. (Ref: Para. A35)

Obtaining Evidence Regarding the Design of Controls

21. The service auditor shall determine which of the controls at the service organization are necessary to achieve the control objectives stated in management's description of the service organization's system and shall assess whether those controls were suitably designed to achieve the control objectives by:
 - (a) Identifying the risks that threaten the achievement of the control objectives stated in management's description of the service organization's system; and
 - (b) Evaluating the linkage of the controls identified in management's description of the service organization's system with those risks. (Ref: Para. A36-A39)

Obtaining Evidence Regarding the Operating Effectiveness of Controls

Assessing Operating Effectiveness

22. When performing a type 2 engagement, the service auditor shall test those controls that the service auditor has determined are necessary to achieve the control objectives stated in management's description of the service organization's system and shall assess their operating effectiveness throughout the period. Evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period. (Ref: Para. A40-A41, A43 and A45)
23. When performing a type 2 engagement, the service auditor shall inquire about changes in the service organization's controls that were implemented during the period covered by the service auditor's report. If the service auditor believes the changes would be considered significant by user entities and their auditors, the service auditor shall determine whether those changes are included in management's description of the service organization's system. If such changes are not included in the description, the service auditor shall describe the changes in the report and determine the effect on the service auditor's report. If the superseded controls are relevant to the achievement of the control objectives stated in the description, the service auditor shall, if possible, test the superseded controls before the change. If the service auditor cannot test superseded controls relevant to the achievement of the control objectives stated in the description, the service auditor shall determine the effect on the service auditor's report. (Ref: Para. A42 and A44)
24. When designing and performing tests of controls, the service auditor shall:
 - (a) Perform other procedures in combination with inquiry to obtain evidence about the following:
 - (i) How the control was applied;
 - (ii) The consistency with which the control was applied; and
 - (iii) By whom or by what means the control was applied.
 - (b) Determine whether the controls to be tested depend on other controls, and if so, whether it is necessary to obtain evidence supporting the operating effectiveness of those other controls; and
 - (c) Determine an effective method for selecting the items to be tested to meet the objectives of the procedure. (Ref: Para. A46-A47)
25. When determining the extent of tests of controls and whether sampling is appropriate, the service auditor shall consider the characteristics of the population of the controls to be tested, including the nature of the controls, the frequency of their application (for example, monthly, daily, many times per day), and the expected rate of deviation. If the service auditor determines that sampling is appropriate, the service auditor shall:
 - (a) Consider the purpose of the procedure;
 - (b) Determine a sample size sufficient to reduce sampling risk to an appropriately low level;
 - (c) Select items for the sample in such a way that each sampling unit in the population has a chance of selection;

- (d) If a designed procedure is not applicable to a selected item, perform the procedure on a replacement item; and
- (e) If unable to apply the designed procedures, or suitable alternative procedures, to a selected item, treat that item as a deviation. (Ref: Para. A46-A47)

Nature and Cause of Deviations

- 26. The service auditor shall investigate the nature and cause of any deviations identified, and shall determine whether:
 - (a) Identified deviations are within the expected rate of deviation and are acceptable. If so, the testing that has been performed provides an appropriate basis for concluding that the control operated effectively throughout the specified period;
 - (b) Additional testing of the control or of other controls is necessary to reach a conclusion about whether the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period; or
 - (c) The testing that has been performed provides an appropriate basis for concluding that the control did not operate effectively throughout the specified period.
- 27. If, as a result of performing the procedures in paragraph 26, the service auditor becomes aware that any identified deviations have resulted from intentional acts by service organization personnel, the service auditor shall assess the risk that management's description of the service organization's system is not fairly presented, the controls are not suitably designed, and in a type 2 engagement, controls are not operating effectively. (Ref: Para. A31)

Using the Work of the Internal Audit Function

Obtaining an Understanding of the Internal Audit Function

- 28. If the service organization has an internal audit function, the service auditor shall obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed in order to determine whether the internal audit function is likely to be relevant to the engagement. (Ref: Para. A48-A49)

Planning to Use the Work of the Internal Audit Function

- 29. When the service auditor intends to use the work of the internal audit function, the service auditor shall determine whether the work of the internal audit function is likely to be adequate for the purposes of the engagement by evaluating:
 - (a) The objectivity and technical competence of members of the internal audit function;
 - (b) Whether the work of the internal audit function is likely to be carried out with due professional care; and
 - (c) Whether there is likely to be effective communication between the internal audit function and the service auditor, including consideration of the effect of any constraints or restrictions placed on the internal audit function by the service organization.

30. If the service auditor determines that the work of the internal audit function is likely to be adequate for the purposes of the engagement, in determining the planned effect of the work of the internal audit function on the nature, timing, or extent of the service auditor's procedures, the service auditor shall evaluate the following:
- (a) The nature and scope of specific work performed, or to be performed, by the internal audit function;
 - (b) The significance of that work to the service auditor's conclusions; and
 - (c) The degree of subjectivity involved in the evaluation of the evidence gathered in support of those conclusions. (Ref: Para. A50)

Using the Work of the Internal Audit Function

31. In order for the service auditor to use specific work of the internal audit function, the service auditor shall evaluate and perform procedures on that work to determine its adequacy for the service auditor's purposes. (Ref: Para. A51)
32. To determine the adequacy of specific work performed by the internal audit function for the service auditor's purposes, the service auditor shall evaluate whether:
- (a) The work was performed by members of the internal audit function having adequate technical training and proficiency;
 - (b) The work was properly supervised, reviewed and documented;
 - (c) Sufficient appropriate evidence has been obtained to enable the internal audit function to draw reasonable conclusions;
 - (d) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal audit function are consistent with the results of the work performed; and
 - (e) Exceptions relevant to the engagement or unusual matters disclosed by the internal audit function are properly resolved.

Effect on the Service Auditor's Report

33. If the work of the internal audit function has been used, the service auditor shall make no reference to that work in the service auditor's opinion. Notwithstanding its degree of autonomy and objectivity, the internal audit function is not independent of the service organization. The service auditor has sole responsibility for the opinion expressed in the service auditor's report and, accordingly, that responsibility is not reduced by the service auditor's use of the work of the internal audit function. (Ref: Para. A52)
34. In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's report that describes the service auditor's tests of controls and results thereof shall include a description of the internal auditor's work and of the service auditor's procedures with respect to that work. (Ref: Para. A53)
35. When the service auditor uses members of the service organization's internal audit function to provide direct assistance, the service auditor shall evaluate the knowledge, competence and independence of such members in relation to the matters subject to the audit. The service auditor shall adequately plan and properly supervise the work of such individuals.

Written Representations

36. The service auditor shall request management to provide written representations:
- (a) That reaffirm its assertion included in or attached to the description of the service organization's system;
 - (b) That it has provided the service auditor with all relevant information and access agreed to; and³
 - (c) That it has disclosed to the service auditor any of the following of which it is aware:
 - (i) Instances of noncompliance with laws and regulations or uncorrected errors attributable to the service organization that may affect one or more user entities;
 - (ii) Knowledge of any actual, suspected, or alleged intentional acts by management or the service organization's employees, that could adversely affect the fairness of management's presentation of the description of the service organization's system or the completeness or achievement of the control objectives stated in the description;
 - (iii) Design deficiencies in controls;
 - (iv) Instances where controls have not operated as described; and
 - (v) Any events subsequent to the period covered by management's description of the service organization's system up to the date of the service auditor's report that could have a significant effect on management's assertion. (Ref: Para A54-A58)
37. If a service organization uses a subservice organization, and management's description of the service organization's system uses the inclusive method, the service auditor also shall obtain the written representations identified in paragraph 36 from management of the subservice organization.
38. The written representations shall be in the form of a representation letter addressed to the service auditor and shall be as of the same date as the date of the service auditor's report.
39. If management does not provide one or more of the written representations requested by the service auditor, the service auditor shall:
- (a) Discuss the matter with management;
 - (b) Evaluate the effect of such refusal on the service auditor's assessment of the integrity of management and evaluate the effect that this may have on the reliability of management's representations and evidence in general; and
 - (c) Take appropriate actions, which may include disclaiming an opinion or withdrawing from the engagement.

³ See paragraph 9(c)(vi) a.

Other Information

40. The service auditor shall read other information, if any, included in a document containing management's description of the service organization's system and the service auditor's report to identify material inconsistencies, if any, with that description. While reading the other information for the purpose of identifying material inconsistencies, the service auditor may become aware of an apparent misstatement of fact in the other information.
41. If the service auditor becomes aware of a material inconsistency or an apparent misstatement of fact in the other information, the service auditor shall discuss the matter with management. If the service auditor concludes that there is a material inconsistency or a misstatement of fact in the other information that management refuses to correct, the service auditor shall take further appropriate action. (Ref: Para. A59-A61)

Subsequent Events

42. The service auditor shall inquire whether management is aware of any events subsequent to the period covered by management's description of the service organization's system up to the date of the service auditor's report that could have a significant effect on management's assertion. If the service auditor becomes aware, through inquiry or otherwise, of such an event, or any other event that is of such a nature and significance that its disclosure is necessary to prevent users from being misled, and information about that event is not disclosed by management in its description, the service auditor shall disclose such event in the service auditor's report.
43. The service auditor has no responsibility to keep informed of events subsequent to the date of the service auditor's report; however, after the service auditor's report is issued, the service auditor may become aware of facts that existed at the report date that might have affected management's assertion and caused the service auditor to amend the service auditor's report had the service auditor been aware of them. The service auditor shall respond appropriately to such facts. (Ref: Para. A62)

Documentation

44. The service auditor shall prepare documentation that is sufficient to enable an experienced service auditor, having no previous connection with the engagement, to understand:
 - (a) The nature, timing, and extent of the procedures performed to comply with this CSAE and with applicable legal and regulatory requirements;
 - (b) The results of the procedures performed and the evidence obtained; and
 - (c) Significant findings or issues arising during the engagement, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.
45. In documenting the nature, timing, and extent of procedures performed, the service auditor shall record:
 - (a) The identifying characteristics of the specific items or matters being tested;
 - (b) Who performed the work and the date such work was completed; and
 - (c) Who reviewed the work performed and the date and extent of such review. (Ref: Para. A63)

46. If the service auditor uses specific work of the internal audit function, the service auditor shall document the conclusions reached regarding the evaluation of the adequacy of the work of the internal audit function, and the procedures performed by the service auditor on that work.
47. The service auditor shall document discussions of significant findings or issues with management and others, including the nature of the significant findings or issues, when the discussions took place, and with whom.
48. If the service auditor has identified information that is inconsistent with the service auditor's final conclusion regarding a significant finding or issue, the service auditor shall document how the service auditor addressed the inconsistency.
49. The service auditor shall assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the service auditor's report.⁴ (Ref: Para. A64)
50. After the assembly of the final engagement file has been completed, the service auditor shall not delete or discard documentation before the end of its retention period.
51. If the service auditor finds it necessary to modify existing engagement documentation or add new documentation after the assembly of the final engagement file has been completed, the service auditor shall, regardless of the nature of the modifications or additions, document:
 - (a) The specific reasons for making them; and
 - (b) When and by whom they were made and reviewed.

Preparing the Service Auditor's Report

Content of the Service Auditor's Report

52. A service auditor's type 2 report shall include the following elements:
 - (a) A title that includes the word independent;
 - (b) An addressee;
 - (c) Identification of:
 - (i) Management's description of the service organization's system and the function performed by the system;
 - (ii) Any parts of management's description of the service organization's system that are not covered by the service auditor's report;
 - (iii) Any information included in a document containing the service auditor's report that is not covered by the service auditor's report;
 - (iv) The criteria; and
 - (v) Any services performed by a subservice organization and whether the carve-out method or the inclusive method was used in relation to them.

⁴ Canadian Standard on Quality Control (CSQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance Engagements," paragraphs A54-A55, provide further guidance.

- a. If the carve-out method was used, a statement that management's description of the service organization's system excludes the control objectives and related controls at relevant subservice organizations, and that the service auditor's procedures do not extend to the subservice organization.
 - b. If the inclusive method has been used, a statement that management's description of the service organization's system includes the subservice organization's specified control objectives and related controls, and that the service auditor's procedures included procedures at or related to the subservice organization.
- (d) If management's description of the service organization's system refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of the design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization;
- (e) A reference to management's assertion and a statement that management is responsible for:
- (i) Preparing the description of the service organization's system and the assertion, including the completeness, accuracy and method of presentation of the description and assertion;
 - (ii) Providing the services covered by the description of the service organization's system;
 - (iii) Specifying the control objectives unless the control objectives are specified by law, regulation, or another party, and stating them in the description of the service organization's system;
 - (iv) Identifying the risks that threaten the achievement of the control objectives;
 - (v) Selecting the criteria; and
 - (vi) Designing, implementing, and documenting, controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description of the service organization's system.
- (f) A statement that the service auditor's responsibility is to express an opinion on the fairness of the presentation of management's description of the service organization's system and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description, based on the service auditor's audit;
- (g) A statement that the audit was conducted in accordance with the Canadian Standard on Assurance Engagements for Reporting on Controls at a Service Organization, set out in the CICA Handbook – Assurance. This standard requires the service auditor to plan and perform the audit to obtain reasonable assurance about whether management's description of the service organization's system is fairly presented and the controls are suitably designed and operating effectively throughout the specified period to achieve the related control objectives;
- (h) A statement that an audit of management's description of a service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description of the system and the suitability of the design and operating effectiveness of those controls to achieve the related control objectives stated in the description;

- (i) A statement that the audit included assessing the risks that management's description of the service organization's system is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives;
- (j) A statement that the audit also included testing the operating effectiveness of those controls that the service auditor considers necessary to provide reasonable assurance that the related control objectives stated in management's description of the service organization's system were achieved;
- (k) A statement that an audit engagement of this type also includes evaluating the overall presentation of management's description of the service organization's system and suitability of the control objectives stated in the description;
- (l) A statement that the service auditor believes the audit provides a reasonable basis for his or her opinion;
- (m) A statement about the inherent limitations of controls, including the risk of projecting to future periods any evaluation of the fairness of the presentation of the service organization's system or conclusions about the suitability of the design or operating effectiveness of controls;
- (n) The service auditor's opinion on whether, in all material respects, based on the criteria described in management's assertion:
 - (i) Management's description of the service organization's system fairly presents the service organization's system that was designed and implemented throughout the specified period;
 - (ii) The controls related to the control objectives stated in management's description of the service organization's system were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively throughout the specified period;
 - (iii) The controls the service auditor tested, which were those necessary to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved, operated effectively throughout the specified period; and
 - (iv) If the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a reference to this condition.
- (o) A reference to a description of the service auditor's tests of controls and the results thereof, that includes:
 - (i) Identification of the controls that were tested, whether the items tested represent all or a selection of the items in the population, and the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk assessments; and
 - (ii) If deviations have been identified in the operation of controls included in the description, the extent of testing performed by the service auditor that led to the identification of the deviations (including the sample size where sampling has been used), and, the number and nature of the deviations noted (even if, on the basis of tests performed, the service auditor concludes that the related control objective was achieved).
- (p) A statement restricting the use of the service auditor's report to management of the service organization, user entities of the service organization's system during some or all of the

period covered by the service auditor's report, and the independent auditors of such user entities;

- (q) The date of the service auditor's report; and
- (r) The name of the service auditor and the location in the jurisdiction where the service auditor practices. (Ref: Para. A65-A70)

53. A service auditor's type 1 report shall include the following elements:

- (a) A title that includes the word independent;
- (b) An addressee;
- (c) Identification of:
 - (i) Management's description of the service organization's system and the function performed by the system;
 - (ii) Any parts of management's description of the service organization's system that are not covered by the service auditor's report;
 - (iii) Any information included in a document containing the service auditor report that is not covered by the service auditor's report;
 - (iv) The criteria; and
 - (v) Any services performed by a subservice organization and whether the carve-out method or the inclusive method was used in relation to them:
 - a. if the carve-out method was used, a statement that management's description of the service organization's system excludes the control objectives and related controls at relevant subservice organizations, and that the service auditor's procedures do not extend to the subservice organization.
 - b. If the inclusive method has been used, a statement that management's description of the service organization's system includes the subservice organization's specified control objectives and related controls, and that the service auditor's procedures included procedures at or related to the subservice organization.
- (d) If management's description of the service organization's system refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of the design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization;
- (e) A reference to management's assertion and a statement that management is responsible for:
 - (i) Preparing the description of the service organization's system and assertion, including the completeness, accuracy and method of presentation of the description and assertion;
 - (ii) Providing the services covered by the description of the service organization's system;

- (iii) Specifying the control objectives, unless the control objectives are specified by law, regulation, or another party, and stating them in the description of the service organization's system;
 - (iv) Identifying the risks that threaten the achievement of the control objectives;
 - (v) Selecting the criteria; and
 - (vi) Designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description of the service organization's system.
- (f) A statement that the service auditor's responsibility is to express an opinion on the fairness of the presentation of management's description of the service organization's system and on the suitability of the design of the controls to achieve the related control objectives stated in the description, based on the service auditor's audit.;
 - (g) A statement that the audit was conducted in accordance with the Canadian Standard on Assurance Engagements for Reporting on Controls at a Service Organization, set out in the CICA Handbook – Assurance. This standard requires the service auditor to plan and perform the audit to obtain reasonable assurance about whether management's description of the service organization's system is fairly presented and the controls are suitably designed as of the specified date to achieve the related control objectives;
 - (h) A statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and, therefore, expresses no opinion thereon;
 - (i) A statement that an audit of management's description of a service organization's system and the suitability of the design of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description of the system and the suitability of the design of those controls to achieve the related control objectives stated in the description;
 - (j) A statement that the audit included assessing the risks that management's description of the service organization's system is not fairly presented and that the controls were not suitably designed to achieve the related control objectives;
 - (k) A statement that an audit engagement of this type also includes evaluating the overall presentation of management's description of the service organization's system and suitability of the control objectives stated in the description;
 - (l) A statement that the service auditor believes the audit provides a reasonable basis for his or her opinion;
 - (m) A statement about the inherent limitations of controls, including the risk of projecting to future periods any evaluation of the fairness of the presentation of management's description of the service organization's system or conclusions about the suitability of the design of the controls to achieve the related control objectives;
 - (n) The service auditor's opinion on whether, in all material respects, based on the criteria described in management's assertion:
 - (i) Management's description of the service organization's system fairly presents the service organization's system that was designed and implemented as of the specified date;
 - (ii) The controls related to the control objectives stated in management's description of the

service organization's system were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively as of the specified date; and

- (iii) If the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a reference to this condition.
- (o) A statement restricting the use of the service auditor's report to management of the service organization, user entities of the service organization's system as of the end of the period covered by the service auditor's report, and the independent auditors of such user entities;
- (p) The date of the service auditor's report; and
- (q) The name of the service auditor and the location in the jurisdiction where the service auditor practices. (Ref: Para A65-A70)

Report Date

54. The service auditor shall date the service auditor's report no earlier than the date on which the service auditor has obtained sufficient appropriate evidence to support the service auditor's opinion.

Modified Opinions

55. The service auditor's opinion shall be modified, and the service auditor's report shall contain a clear description of all the reasons for the modification, if the service auditor concludes that:
- (a) Management's description of the service organization's system is not fairly presented, in all material respects;
 - (b) The controls are not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated as described;
 - (c) In the case of a type 2 report, the controls did not operate effectively throughout the specified period to achieve the related control objectives stated in management's description of the service organization's system; or
 - (d) The service auditor is unable to obtain sufficient, appropriate evidence. (Ref: Para. A71)
56. If the service auditor plans to disclaim an opinion because of the inability to obtain sufficient appropriate evidence, and, based on the limited procedures performed has concluded that:
- (a) Certain aspects of management's description of the service organization's system are not fairly presented, in all material respects; or
 - (b) Certain controls were not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated as described; or

- (c) In the case of a type 2 report, certain controls did not operate effectively throughout the specified period to achieve the related control objectives stated in management's description of the service organization's system;

the service auditor shall identify these findings in his or her report.

- 57. If the service auditor plans to disclaim an opinion, the service auditor shall not identify the procedures that were performed nor include statements describing the characteristics of a service auditor's engagement in the service auditor's report; to do so might overshadow the disclaimer.

Other Communication Responsibilities

- 58. If the service auditor becomes aware of incidents of noncompliance with laws and regulations, fraud, or uncorrected errors attributable to management or other service organization personnel that are not clearly trivial and that may affect one or more user entities, the service auditor shall determine the effect of such incidents on management's description of the service organization's system, the achievement of the control objectives, and the service auditor's report. Additionally, 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 shall take appropriate action. (Ref: Para. A72)

Application and Other Explanatory Material

Scope of this Canadian Standard on Assurance Engagements (Ref: Para. 1-4)

- A1. Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives related to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Controls related to a service organization's operations and compliance objectives may be relevant to a user entities' internal control over financial reporting. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions or disclosures, or may pertain to evidence that the user auditor evaluates or uses in applying auditing procedures. For example, a payroll processing service organization's controls related to the timely remittance of payroll deductions to government authorities may be relevant to a user entity as late remittances could incur interest and penalties that would result in a liability for the user entity. Similarly, a service organization's controls over the acceptability of investment transactions from a regulatory perspective may be considered relevant to a user entity's presentation and disclosure of transactions and account balances in its financial statements.
- A2. Paragraph 2 of this CSAE refers to other engagements that the practitioner may perform and report under Section 5025 to report on controls at a service organization. Paragraph 2 is not, however, intended to:
 - (a) Provide for the alteration of the definitions of "service organization" and "service organization's system," in paragraph 7, to permit reports issued under this CSAE to include in the description of the service organization's system aspects of their services (including relevant control objectives and related controls) not likely to be relevant to user entities' internal control over financial reporting; or
 - (b) Permit reports issued under this CSAE on a service organization's controls that are likely to be relevant to user entities' internal control over financial reporting to be combined with

reports issued under Section 5025 on controls at a service organization that are not likely to be relevant to user entities' internal control over financial reporting.

- A3. When a service auditor conducts an engagement under Section 5025 to report on controls at a service organization other than those controls likely to be relevant to user entities' internal control over financial reporting, and the service auditor intends to use the guidance in this CSAE in planning and performing that engagement, the service auditor may encounter issues that differ significantly from those associated with engagements to report on a service organization's controls likely to be relevant to user entities' internal control over financial reporting. For example:
- Identification of suitable and available criteria, as prescribed in Section 5025, for evaluating the fairness of presentation of management's description of the service organization's system and the suitability of the design and the operating effectiveness of the controls.
 - Identification of appropriate control objectives, and the basis for evaluating the reasonableness of the control objectives in the circumstances of the particular engagement.
 - Identification of the intended users of the report and the manner in which they intend to use the report.
 - Relevance and appropriateness of the definitions in paragraph 7 of this CSAE, many of which specifically relate to internal control over financial reporting.
 - Application of the concept of materiality in the circumstances of the particular engagement.
 - Developing the language to be used in the practitioner's report, including addressing paragraph 5025.62, which identifies the elements to be included in the practitioner's report.
- A4. Where management of the service organization is not responsible for the design of the system, it is unlikely that management of the service organization will be in a position to assert that the system is suitably designed. Controls cannot operate effectively unless they are suitably designed. Because of the inextricable link between the suitability of the design of controls and their operating effectiveness, the absence of an assertion with respect to the suitability of design will likely preclude the service auditor from opining on the operating effectiveness of controls. As an alternative, the practitioner may perform tests of controls in either an agreed-upon procedures engagement under Section 9110,⁵ or an audit of the operating effectiveness of the controls under Section 5025.

Definitions

Controls at a Service Organization (Ref: Para. 7(d))

- A5. The policies and procedures referred to in the definition of "controls at a service organization" in paragraph 7 include aspects of user entities' information systems maintained by the service organization and may also include aspects of one or more of the other components of internal control at a service organization. For example, the definition of controls at a service organization may include aspects of the service organization's control environment, monitoring, and control activities when they relate to the services provided. Such definition does not, however, include controls at a service organization that are not related to the achievement of the control objectives stated in management's description of the service organization's system, for example, controls related to the preparation of the service organization's own financial statements.

⁵ AGREED-UPON PROCEDURES REGARDING INTERNAL CONTROL OVER FINANCIAL REPORTING, Section 9110.

Criteria (Ref: Para. 7(f))

- A6. For the purposes of engagements performed in accordance with this CSAE, criteria need to be available to user entities and their auditors to enable them to understand the basis for the service organization's assertion about the fair presentation of management's description of the service organization's system, the suitability of the design of controls addressing control objectives stated in the description of the system and, in the case of a type 2 report, the operating effectiveness of such controls. Information about suitable criteria is provided in paragraphs 5025.32-42. Paragraphs 14-16 of this CSAE discuss the criteria for evaluating the fairness of the presentation of management's description of the service organization's system and the suitability of the design and operating effectiveness of the controls.

Inclusive Method (Ref: Para. 7(g))

- A7. As indicated in the definition of "inclusive method" in paragraph 7, a service organization that uses a subservice organization presents management's description of the service organization's system to include a description of the services provided by the subservice organization as well as the subservice organization's relevant control objectives and related controls. When the inclusive method is used, the requirements of this CSAE also apply to the services provided by the subservice organization, including the requirement to obtain management's acknowledgement and acceptance of responsibility for the matters in paragraph 9(c)(i)-(vii) as they relate to the subservice organization.
- A8. Performing procedures at the subservice organization entails coordination and communication between the service organization, the subservice organization, and the service auditor. The inclusive method generally is feasible if, for example, the service organization and the subservice organization are related, or if the contract between the service organization and the subservice organization provides for issuance of a service auditor's report. If the service auditor is unable to obtain an assertion from the subservice organization regarding management's description of the service organization's system provided, including the relevant control objectives and related controls at the subservice organization, the service auditor is unable to use the inclusive method but may instead use the carve-out method.
- A9. There may be instances where the service organization's controls, such as monitoring controls, permit the service organization to include in its assertion the relevant aspects of the subservice organization's system, including the relevant control objectives and related controls of the subservice organization. In such instances, the service auditor is basing his or her opinion solely on the controls at the service organization, and hence, the inclusive method is not applicable.

Internal Audit Function (Ref: Para. 7(h))

- A10. The "others" referenced in the definition of *internal audit function* may be individuals who perform activities similar to those performed by internal auditors and include service organization personnel (in addition to internal auditors), and third parties working under the direction of management or those charged with governance.

Service Organization's System (Ref: Para. 7(n))

- A11. The policies and procedures referred to in the definition of "service organization's system" refer to the guidelines and activities for providing transaction processing and other services to user entities and include the infrastructure, software, people, and data that support the policies and procedures.

Management and Those Charged with Governance (Ref: Para. 8)

A12. Management and governance structures vary by entity, reflecting influences such as size and ownership characteristics. Such diversity means that it is not possible for this CSAE to specify for all engagements the person(s) with whom the service auditor is to interact regarding particular matters. For example, the service organization may be a segment of an organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance from whom to request written representations may require the exercise of professional judgment.

Acceptance and Continuance (Ref: Para. 9)

A13. If one or more of the conditions in paragraph 9 are not met and the service auditor is nevertheless required by law or regulation to accept or continue an engagement to report on controls at a service organization, the service auditor is required, in accordance with the requirements in paragraphs 55 and 56, to determine the effect on the service auditor's report of one or more of such conditions not being met.

Capabilities and Competence to Perform the Engagement (Ref: Para. 9(a))

A14. Relevant capabilities and competence to perform the engagement include matters such as the following:

- Knowledge of the relevant industry.
- An understanding of information technology and systems.
- Experience in evaluating risks as they relate to the suitable design of controls.
- Experience in the design and execution of tests of controls and the evaluation of the results.

A15. In performing a service auditor's engagement, the service auditor need not be independent of each user entity.

Management's Responsibility for Documenting the Service Organization's System (Ref: Para. 9(c)(i))

A16. Management of the service organization is responsible for documenting the service organization's system. No one particular form of documentation is prescribed and the extent of documentation may vary depending upon the size and complexity of the service organization and its monitoring activities.

Reasonable Basis for Management's Assertion (Ref: Para. 9(c)(ii) and 14(a)(vii))

A17. Management's monitoring activities may provide evidence of the design and operating effectiveness of controls in support of management's assertion. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the service organization, and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities. Internal auditors or personnel performing similar functions may contribute to the monitoring of a service organization's activities. Monitoring activities may also include using information communicated by external parties, such as customer complaints and regulator comments, which may indicate problems or highlight areas in need of improvement. The greater the degree and effectiveness of ongoing monitoring, the less need for separate evaluations. Usually, some

combination of ongoing monitoring and separate evaluations will ensure that internal control maintains its effectiveness over time. The service auditor's report on controls is not a substitute for the service organization's own processes to provide a reasonable basis for its assertion.

Identification of Risks (Ref: Para. 9 (c)(v))

- A18. Control objectives relate to risks that controls seek to mitigate. For example, the risk that a transaction is recorded at the wrong amount or in the wrong period can be expressed as a control objective that transactions are recorded at the correct amount and in the correct period. Management is responsible for identifying the risks that threaten achievement of the control objectives stated in management's description of the service organization's system. Management may have a formal or informal process for identifying relevant risks. A formal process may include estimating the significance of identified risks, assessing the likelihood of their occurrence, and deciding about actions to address them. However, since control objectives relate to risks that controls seek to mitigate, thoughtful identification by management of control objectives when designing, implementing, and documenting the service organization's system may itself comprise an informal process for identifying relevant risks.

Management's Refusal to Provide a Written Assertion (Ref: Para. 10-11)

- A19. A recent change in service organization management or the appointment of the service auditor by a party other than management are examples of situations that may cause management to be unwilling to provide the service auditor with a written assertion. However, there may be other members of management who are in a position to, and will agree to, sign the assertion so that the service auditor can meet the requirement of paragraph 9(c)(vii).

Request to Change the Scope of the Engagement (Ref: Para. 12)

- A20. A request to change the scope of the engagement may not have a reasonable justification if, for example, the request is made:
- To exclude certain control objectives at the service organization from the scope of the engagement because of the likelihood that the service auditor's opinion would be modified with respect to those control objectives.
 - To prevent the disclosure of deviations identified at a subservice organization by requesting a change from the inclusive method to the carve-out method.
- A21. A request to change the scope of the engagement may have a reasonable justification when, for example, the request is made to exclude from the engagement a subservice organization when the service organization cannot arrange for access by the service auditor, and the method used for addressing the services provided by that subservice organization is changed from the inclusive method to the carve-out method.

Assessing the Suitability of the Criteria (Ref: Para. 13-16)

- A22. Section 5025 requires a practitioner, among other things, to identify or develop criteria that are suitable for evaluating the subject matter. Regardless of who establishes or develops the criteria, as indicated in paragraph 9 (c)(iii), management is responsible for selecting the criteria. The subject matter is the underlying condition of interest to intended users of an assurance report. The following table identifies the subject matter and minimum criteria for each of the opinions in type 2 and type 1 reports.

	Subject matter	Criteria	Comment	
<i>Opinion on the fair presentation of management's description of the service organization's system (type 1 and type 2 reports).</i>	Management's description of the service organization's system that is likely to be relevant to user entities' internal control over financial reporting and is covered by the service auditor's report, and management's assertion about whether the description is fairly presented.	<p>Management's description of the service organization's system is fairly presented if it:</p> <p>a. presents how the service organization's system was designed and implemented including, as appropriate, the matters identified in paragraph 14(a) and, in the case of a type 2 report, includes relevant details of changes to the service organization's system during the period covered by the description.</p> <p>b. does not omit or distort information relevant to the service organization's system, while acknowledging that management's description of the service organization's system is prepared to meet the common needs of a broad range of user entities and may not, therefore, include every aspect of the service organization's system that each individual user entity may consider important in its own particular environment.</p>	The specific wording of the criteria for this opinion may need to be tailored to be consistent with criteria established by, for example, law, regulation, user groups, or a professional body. Criteria for evaluating management's description of the service organization's system are provided in paragraph 14. Paragraphs 19-20 and A31-A33 offer further guidance on determining whether these criteria are met.	
<i>Opinion on suitability of design and operating effectiveness (type 2 reports).</i>	The design and operating effectiveness of the controls that are necessary to achieve the control objectives stated in management's description of the service organization's system.	<p>The controls are suitably designed and operating effectively to achieve the control objectives stated in management's description of the service organization's system if:</p> <p>a. management has identified the risks that threaten the achievement of the control objectives stated in management's description of the service organization's system.</p> <p>b. the controls identified in</p>	When the criteria for this opinion is met, controls will have provided reasonable assurance that the related control objectives stated in management's description of the service organization's system were achieved throughout the specified period.	The control objectives stated in management's description of the service organization's system are part of the criteria for these opinions. The control objectives stated in the description will differ from engagement to engagement. If the service auditor concludes that the control objectives stated in the description are not fairly presented, then those control objectives

	Subject matter	Criteria	Comment
		<p>management's description of the service organization's system would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.</p> <p>c. the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority.</p>	would not be suitable as part of the criteria for forming an opinion on the design and operating effectiveness of the controls.
Opinion on suitability of design (type 1 reports).	The suitability of the design of the controls necessary to achieve the control objectives stated in management's description of the service organization's system and relevant to the services covered by the service auditor's report.	<p>The controls are suitably designed to achieve the control objectives stated in management's description of the service organization's system if:</p> <p>a. management has identified the risks that threaten the achievement of the control objectives stated in its description of the service organization's system.</p> <p>b. the controls identified in management's description of the service organization's system would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.</p>	Meeting these criteria does not, of itself, provide any assurance that the control objectives stated in management's description of the service organization's system were achieved because no evidence has been obtained about the operating effectiveness of the controls.

A23. Paragraph 14(a) identifies a number of elements that are included in management's description of the service organization's system as appropriate. These elements may not be appropriate if the system being described is not a system that processes transactions, for example, if the system relates to general controls over the hosting of an IT application but not the controls embedded in the application itself.

- A24. The requirement to include in management’s description of the service organization’s system “other aspects of the service organization’s control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls, that are relevant to achieving the control objectives stated in the description” is also applicable to the internal control components of subservice organizations used by the service organization when the inclusive method is used.

Materiality (Ref: Para. 17)

- A25. In an engagement to report on controls at a service organization, the concept of materiality relates to the information being reported on, not the financial statements of user entities. The service auditor plans and performs procedures to determine whether management’s description of the service organization’s system is fairly presented, in all material respects; whether controls at the service organization are suitably designed in all material respects to achieve the control objectives stated in the description; and in the case of a type 2 report, whether controls at the service organization operated effectively throughout the specified period in all material respects to achieve the control objectives stated in the description. The concept of materiality takes into account that the service auditor’s report provides information about the service organization’s system to meet the common information needs of a broad range of user entities and their auditors who have an understanding of the manner in which the system is being used by a particular user entity for financial reporting.
- A26. Materiality with respect to the fair presentation of management’s description of the service organization’s system, and with respect to the design of controls, primarily includes the consideration of qualitative factors, for example, whether:
- Management’s description of the service organization’s system includes the significant aspects of the processing of significant transactions.
 - Management’s description of the service organization’s system omits or distorts relevant information.
 - The controls have the ability, as designed, to provide reasonable assurance that the control objectives stated in management’s description of the service organization’s system would be achieved.

Materiality with respect to the operating effectiveness of controls includes the consideration of both quantitative and qualitative factors, for example, the tolerable rate and observed rate of deviation (a quantitative matter) and the nature and cause of any observed deviations (a qualitative matter).

- A27. The concept of materiality is not applied when disclosing, in the description of the tests of controls, the results of those tests where deviations have been identified. This is because, in the particular circumstances of a specific user entity or user auditor, a deviation may have significance beyond whether or not, in the opinion of the service auditor, it prevents a control from operating effectively. For example, the control to which the deviation relates may be particularly significant in preventing a certain type of error that may be material in the particular circumstances of a user entity’s financial statements.

Obtaining an Understanding of the Service Organization's System (Ref: Para. 18)

- A28. Obtaining an understanding of the service organization's system, including related controls, assists the service auditor in the following:
- Identifying the boundaries of the system and how it interfaces with other systems.
 - Assessing whether management's description of the service organization's system fairly presents the service organization's system that has been designed and implemented.
 - Determining which controls are necessary to achieve the control objectives stated in management's description of the service organization's system, whether controls were suitably designed to achieve those control objectives, and, in the case of a type 2 report, whether controls were operating effectively throughout the period to achieve those control objectives.
- A29. Management's description of the service organization's system includes "aspects of the service organization's control environment, risk assessment process, information and communication systems (including relevant business processes), control activities and monitoring activities that are relevant to the services provided." While aspects of the service organization's control environment, risk assessment process, and monitoring activities may not be presented in the description in the context of control objectives, they may nevertheless be necessary to achieve the specified control objectives stated in the description. Likewise, deficiencies in these controls may have an effect on the service auditor's assessment of whether the controls, taken as a whole, were suitably designed and/or operating effectively to achieve the specified control objectives.
- A30. The service auditor's procedures to obtain the understanding referred to in paragraph A28 may include the following:
- Inquiring of management and others within the service organization who, in the service auditor's judgment, may have relevant information.
 - Observing operations and inspecting documents, reports, and printed and electronic records of transaction processing.
 - Inspecting a selection of agreements between the service organization and user entities to identify their common terms.
 - Reperforming the application of a control.

One or more of the procedures above may be accomplished through the performance of a walkthrough.

Obtaining Evidence Regarding Management's Description of the Service Organization's System (Ref: Para. 19-20 and 27)

- A31. In a service auditor's audit engagement, the service auditor plans and performs the engagement to obtain reasonable assurance of detecting errors or omissions in management's description of the service organization's system and instances in which control objectives were not achieved. Absolute assurance is not attainable because of factors such as the need for judgment, the use of sampling, and the inherent limitations of controls at the service organization that affect whether the description is fairly presented and the controls are suitably designed and operating effectively to achieve the control objectives, and because much of the evidence available to the service auditor is persuasive rather than conclusive in nature. Also, procedures that are effective for

detecting unintentional errors or omissions in the description, and instances in which control objectives were not achieved may be ineffective for detecting intentional errors or omissions in the description and instances in which the control objectives were not achieved that are concealed through collusion between service organization personnel and a third party or among management or employees of the service organization. Therefore, the subsequent discovery of the existence of material omissions or errors in the description or instances in which control objectives were not achieved does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the service auditor.

A32. Considering the following questions may assist the service auditor in determining whether management's description of the service organization's system is fairly presented, in all material respects:

- Does management's description address the major aspects of the service provided and included in the scope of the engagement that could reasonably be expected to be relevant to the common needs of a broad range of user auditors in planning their audits of user entities' financial statements?
- Is the description prepared at a level of detail that could reasonably be expected to provide a broad range of user auditors with sufficient information to obtain an understanding of internal control as it relates to identifying and assessing risks of material misstatement in the audit of financial statements of the user entities? The description need not address every aspect of the service organization's processing or the services provided to user entities and need not be so detailed that it would potentially enable a reader to compromise security or other controls at the service organization.
- Is the description prepared in a manner that does not omit or distort information that might affect the decisions of a broad range of user auditors; for example, does the description contain any significant omissions or inaccuracies regarding processing of which the service auditor is aware?
- Does the description include relevant details of changes to the service organization's system during the period covered by the description when the description covers a period of time?
- Have the controls identified in the description actually been implemented?
- Are complementary user entity controls, if any, adequately described? In most cases, the control objectives stated in the description are worded so that they are capable of being achieved through the effective operation of controls implemented by the service organization alone. In some cases, however, the control objectives stated in the description cannot be achieved by the service organization alone because their achievement requires particular controls to be implemented by user entities. This may be the case when, for example, the control objectives are specified by a regulatory authority. When the description does include complementary user entity controls, the description separately identifies those controls along with the specific control objectives that cannot be achieved by the service organization alone.
- If the inclusive method has been used, does the description separately identify controls at the service organization and controls at the subservice organization? If the carve-out method is used, does the description identify the functions that are performed by the subservice organization? When the carve-out method is used, the description need not describe the detailed processing or controls at the subservice organization.

A33. The service auditor's procedures to evaluate the fair presentation of management's description of the service organization's system may include the following:

- Considering the nature of the user entities and how the services provided by the service organization are likely to affect them, for example, the predominant types of user entities, and whether the user entities are regulated by government agencies.
- Reading contracts with user entities to gain an understanding of the service organization's contractual obligations.
- Observing procedures performed by service organization personnel.
- Reviewing the service organization's policy and procedure manuals and other documentation of the system, for example, flowcharts and narratives.
- Performing walkthroughs of transactions through the service organization's system.

A34. Paragraph 19(a) requires the service auditor to evaluate whether the control objectives stated in management's description of the service organization's system are reasonable in the circumstances. Considering the following questions may assist the service auditor in this evaluation:

- Have the control objectives stated in the description been specified by the service organization or by outside parties, such as regulatory authorities, a user group, a professional body, or others?
- Do the control objectives stated in the description and specified by the service organization 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 (for example, assertions about existence and accuracy that are affected by access controls that prevent or detect unauthorized access to the system)? 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 the services being provided is used to identify the types of assertions to which those controls are likely to relate.
- Are the control objectives stated in the description and specified by the service organization complete? While 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 assertions commonly embodied in user entities' financial statements, 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 and cannot, therefore, determine whether control objectives are complete from the viewpoint of individual user entities or user auditors. It is the responsibility of individual user entities or user auditors to assess whether the service organization's description addresses the particular control objectives that are relevant to their needs. If the control objectives are specified by an outside party, including control objectives specified by law or regulation, the outside party is responsible for their completeness and reasonableness.

A35. The service auditor's procedures to determine whether the system described by the service organization has been implemented may be similar to, and performed in conjunction with, procedures to obtain an understanding of that system. Other procedures that the service auditor may use in combination with inquiry of management and other service organization personnel include observation, inspection of records and other documentation, as well as reperformance of the manner in which transactions are processed through the system and controls are applied.

Obtaining Evidence Regarding the Design of Controls (Ref: Para. 21)

- A36. The risks and control objectives identified in paragraph 21(a) encompass intentional and unintentional acts that threaten the achievement of the control objectives.
- A37. From the viewpoint of a *user auditor*, a control is suitably designed to achieve the control objectives stated in management's description of the service organization's system if individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that material misstatements are prevented or detected and corrected. A *service auditor*, however, is not aware of the circumstances at individual user entities that would affect whether or not a misstatement resulting from a control deficiency is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is suitably designed if individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that the control objective(s) stated in the description of the service organization's system are achieved.
- A38. A service auditor may consider using flowcharts, questionnaires, or decision tables to facilitate understanding the design of the controls.
- A39. Controls may consist of a number of activities directed at the achievement of various control objectives. Consequently, if the service auditor evaluates certain activities as being ineffective in achieving a particular control objective, the existence of other activities may allow the service auditor to conclude that controls related to the control objective are suitably designed to achieve the control objective.

Obtaining Evidence Regarding the Operating Effectiveness of Controls (Ref: Para. 22-27)

- A40. From the viewpoint of a *user auditor*, a control is operating effectively if individually or in combination with other controls, it provides reasonable assurance that material misstatements whether due to fraud or error are prevented, or detected and corrected. A *service auditor*, however, is not aware of the circumstances at individual user entities that would affect whether or not a misstatement resulting from a control deviation is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is operating effectively if individually or in combination with other controls, it provides reasonable assurance that the control objectives stated in management's description of the service organization's system are achieved. Similarly, a service auditor is not in a position to determine whether any observed control deviation would result in a material misstatement from the viewpoint of an individual user entity.
- A41. Obtaining an understanding of controls sufficient to opine on the suitability of their design is not sufficient evidence regarding their operating effectiveness unless there is some automation that provides for the consistent operation of the controls as they were designed and implemented. For example, obtaining information about the implementation of a manual control at a point in time does not provide evidence about operation of the control at other times. However, because of the inherent consistency of IT processing, performing procedures to determine the design of an automated control and whether it has been implemented may serve as evidence of that control's operating effectiveness, depending on the service auditor's assessment and testing of controls such as those over program changes.
- A42. A type 2 report that covers a period that is less than six months is unlikely to be useful to user entities and their auditors. If management's description of the service organization's system covers a period that is less than six months, the description may describe the reasons for the shorter period, and the service auditor's report may include that information as well. Circumstances that may result in a report covering a period of less than six months include the following:

- The service auditor was engaged close to the date by which the report on controls is to be issued, and controls cannot be tested for operating effectiveness for a six month period.
 - The service organization or a particular system or application has been in operation for less than six months.
 - Significant changes have been made to the controls, and it is not practicable either to wait six months before issuing a report or to issue a report covering the system both before and after the changes.
- A43. Evidence about the satisfactory operation of controls in prior periods does not provide evidence of the operating effectiveness of controls during the current period. The service auditor expresses an opinion on the effectiveness of controls throughout each period; therefore, sufficient, appropriate evidence about the operating effectiveness of controls throughout the current period is required for the service auditor to express that opinion for the current period. Knowledge of deviations observed in prior engagements may, however, lead the service auditor to increase the extent of testing during the current period.
- A44. Determining the effect of changes in the service organization's controls that were implemented during the period covered by the service auditor's report involves gathering information about the nature and extent of such changes, how they affect processing at the service organization, and how they might affect assertions in the user entities' financial statements.
- A45. Certain controls may not leave evidence of their operation that can be tested at a later date and, accordingly, the service auditor may find it appropriate to test the operating effectiveness of such controls at various times throughout the reporting period.

Means of Selecting Items for Testing

- A46. The means of selecting items for testing available to the service auditor are:
- (a) Selecting all items (100% examination). This may be appropriate for testing controls that are applied infrequently, for example, quarterly, or when evidence regarding application of the control makes 100% examination efficient;
 - (b) Selecting specific items. This may be appropriate where 100% examination would not be efficient and sampling would not be effective, such as testing controls that are not applied sufficiently frequently to render a large population for sampling, for example, controls that are applied monthly or weekly; and
 - (c) Sampling. This may be appropriate for testing controls that are applied frequently in a uniform manner and which leave documentary evidence of their application.
- A47. While selective examination of specific items will often be an efficient means of obtaining evidence, it does not constitute sampling. The results of procedures applied to items selected in this way cannot be projected to the entire population; accordingly, selective examination of specific items does not provide evidence concerning the remainder of the population. Sampling, on the other hand, is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

Using the Work of an Internal Audit Function

Obtaining an Understanding of the Internal Audit Function (Ref: Para. 28)

- A48. An internal audit function may be responsible for providing analyses, evaluations, assurances, recommendations, and other information to management and those charged with governance. An internal audit function at a service organization may perform activities related to the service organization's internal control or activities related to the services and systems, including controls that the service organization provides to user entities.
- A49. The scope and objectives of an internal audit function vary widely and depend on the size and structure of the service organization and the requirements of management and those charged with governance. Internal audit function activities may include one or more of the following:
- Monitoring the service organization's internal control or the application processing systems. This may include controls relevant to the services provided to user entities. The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation, and recommending improvements thereto.
 - Examination of financial and operating information. The internal audit function may be assigned to review the means by which the service organization identifies, measures, classifies, and reports financial and operating information; to make inquiries about specific matters; and to perform other procedures including detailed testing of transactions, balances, and procedures.
 - Evaluation of the economy, efficiency, and effectiveness of operating activities including nonfinancial activities of the service organization.
 - Evaluation of compliance with laws, regulations, and other external requirements and with management policies, directives, and other internal requirements.

Planning to Use the Work of the Internal Audit Function (Ref: Para. 29-30)

- A50. Factors that are relevant to the service auditor's determination of the extent to which the service auditor may use the work of the service organization's internal audit function include:
- The competence and objectivity of the persons whose work the service auditor plans to use.
 - The risk that a control is not suitably designed or, in the case of a type 2 report, operating effectively to achieve the related control objectives.
 - The degree of subjectivity involved in the evaluation of the evidence.

Using the Work of the Internal Audit Function (Ref: Para. 31-32)

- A51. The nature, timing and extent of the service auditor's procedures on specific work of the internal auditors will depend on the service auditor's assessment of the significance of that work to the service auditor's conclusions (for example, the significance of the risks that the controls tend to mitigate), the evaluation of the internal audit function, and the evaluation of the specific work of the internal auditors. Such procedures may include:
- Examination of items already examined by the internal auditors.
 - Examination of other similar items.
 - Observation of procedures performed by the internal auditors.

Effect on the Service Auditor's Report (Ref: Para. 33-34)

- A52. The responsibility to report on management's description of the service organization's system and the suitability of the design and operating effectiveness of controls rests solely with the service auditor and cannot be shared with the internal audit function. Therefore the judgments about the significance of deviations in the design or operating effectiveness of controls, the sufficiency of tests performed, the evaluation of identified deficiencies, and other matters affecting the service auditor's report are those of the service auditor. In making judgments about the extent of the effect of the work of the internal audit function on the service auditor's procedures, the service auditor may determine, based on risk associated with the controls and the significance of the judgments relating to them, that the service auditor will perform the work relating to some or all of the controls rather than using the work performed by the internal audit function.
- A53. In the case of a type 2 report where the work of the internal audit function has been used in performing tests of controls, the service auditor's description of that work and of the service auditor's procedures with respect to that work may be presented in a number of ways, for example:
- By including introductory material to the description of tests of controls indicating that certain work of the internal audit function was used in performing tests of controls.
 - Attribution of individual tests to internal audit.

Written Representations (Ref: Para. 36-39)

- A54. Written representations reaffirming the service organization's assertion about the effective operation of controls may be based on ongoing monitoring activities, separate evaluations, or a combination of the two (see paragraph A17).
- A55. In certain circumstances, a service auditor may obtain written representations from parties in addition to management of the service organization, such as those charged with governance.
- A56. The written representations required by paragraph 36 are separate from, and in addition to, the assertion included in or attached to management's description of the service organization's system required by paragraph 9(c)(vii).
- A57. If the service auditor is unable to obtain written representations regarding relevant control objectives and related controls at the subservice organization, management of the service organization would be unable to use the inclusive method but could use the carve-out method.
- A58. In addition to the written representations required by paragraph 36, the service auditor may consider it necessary to request other written representations.

Other Information (Ref: Para. 40-41)

- A59. The other information referred to in paragraphs 40 and 41 may be:
- (a) Information provided by the service organization and included in a section of the service auditor's type 1 or type 2 report; or
 - (b) Information outside the service auditor's type 1 or type 2 report included in a document that contains the service auditor's report. This other information may be provided by the service organization or by another party.

- A60. If other information included in a document containing management's description of the service organization's system and the service auditor's assurance report contains future-oriented information that cannot be reasonably substantiated, the service auditor may request that information be removed or revised.
- A61. If the service organization refuses to remove or restate the other information, further actions that may be appropriate include, for example:
- Requesting the service organization to consult with its legal counsel as to the appropriate course of action.
 - Describing the material inconsistency or material misstatement of fact in the assurance report.
 - Withholding the assurance report until the matter is resolved.
 - Withdrawing from the engagement.

Subsequent Events (Ref: Para. 42-43)

- A62. The service auditor may consider the guidance in CAS 560⁶ in determining an appropriate response. The evaluation of subsequent information as described in paragraph 43 is similar to the evaluation of information discovered subsequent to the date of the report on an audit of financial statements as described in CAS 560.

Documentation (Ref: Para. 44-51)

- A63. Section 5030⁷, requires the implementation of quality control procedures that are applicable to the individual assurance engagement. Paragraphs 5030.26-.35 address engagement performance, supervision responsibilities, and review responsibilities. The requirement to review the working papers, does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what work was reviewed, who reviewed such work, and when it was reviewed.
- A64. CSQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of engagement files.⁸ An appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the service auditor's report.

Preparing the Service Auditor's Report (Ref: Para. 52-53)

Content of the Service Auditor's Report

- A65. Examples of service auditors' reports are contained in Appendices 1-3, and illustrative assertions by management of the service organization are presented in Appendix 4.
- A66. The service organization's assertion may be presented in management's description of the service organization's system or may be attached to the description.

⁶ CAS 560, "Subsequent Events."

⁷ QUALITY CONTROL PROCEDURES FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION, Section 5030.

⁸ CSQC 1, paragraph 45.

Use of the Service Auditor's Report

- A67. Paragraph 5025.40 requires that the practitioner's report include a caution that the report is intended only for the use of the intended users when the criteria used to evaluate or measure the subject matter are available only to an identifiable limited group of users and the practitioner is satisfied such users agree their needs are met by using this criteria. The criteria used for engagements to report on controls at a service organization are relevant only for the purpose of providing information about the service organization's system, including controls, to those who have an understanding of how the system is used for financial reporting by user entities and, accordingly, the service auditor's report states that the report and the description of tests of controls are intended only for use by management of the service organization, user entities of the service organization ("during some or all of the period covered by the report" for a type 2 report) ("as of the ending date of the period covered by the report" for a type 1 report), and their user auditors. (The illustrative service auditor's reports in Appendix 1 illustrate language for a paragraph restricting the use of a service auditor's report.)
- A68. Although a service auditor is not responsible for controlling a service organization's distribution of a service auditor's report, a service auditor may inform the service organization that:
- A service auditor's type 1 report is not intended for distribution to parties other than the service organization, user entities of the service organization's system as of the end of the period covered by the service auditor's report, and their user auditors.
 - A service auditor's type 2 report is not intended for distribution to parties other than the service organization, user entities of the service organization's system during some or all of the period covered by the service auditor's report, and their user auditors.
- A69. A user entity is also considered a user entity of the service organization's subservice organizations if controls at subservice organizations are relevant to internal control over financial reporting of the user entity. In such case, the user entity is referred to as an indirect or downstream user entity of the subservice organization. Consequently, an indirect or downstream user entity may be included in the group to whom use of the service auditor report is restricted if controls at the service organization are relevant to internal control over financial reporting of such indirect or downstream user entity.

Description of the Service Auditor's Tests of Controls and the Results Thereof

- A70. In describing the service auditor's tests of controls for a type 2 report, it assists readers if the service auditor's report includes information about causative factors for identified deviations, to the extent the service auditor has identified such factors.

Modified Opinions (Ref: Para. 55-57)

- A71. Examples of elements of modified service auditor's reports are presented in Appendix 2.

Other Communication Responsibilities (Ref: Para. 58)

- A72. Actions that a service auditor may take when he or she becomes aware of noncompliance with laws and regulations, fraud, or uncorrected errors at the service organization, (after giving additional consideration to instances in which the service organization has not appropriately communicated this information to affected user entities, and the service organization is unwilling to do so) include the following:
- Obtaining legal advice about the consequences of different courses of action.
 - Communicating with those charged with governance of the service organization.

- Modifying the service auditor's opinion or adding an emphasis of a matter paragraph.
- Communicating with third parties, for example, a regulator, when required to do so.
- Withdrawing from the engagement.

Illustrative Service Auditor's Reports

The following illustrative reports are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Type 2 Service Auditor's Report

Independent Service Auditor's Report on a Description of a Service Organization's System and the Suitability of the Design and Operating Effectiveness of Controls

To: XYZ Service Organization

Scope

We have audited XYZ Service Organization's description of its [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [*date*] to [*date*] (description) and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description.

Service organization's responsibilities

On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for the assertion, including the completeness, accuracy, and method of presentation of the description and the assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Service auditor's responsibilities

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description, based on our audit. We conducted our audit in accordance with the Canadian Standard on Assurance Engagements for Reporting on Controls at a Service Organization, set out in the CICA Handbook – Assurance. This standard requires that we plan and perform our audit to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls were suitably designed and operating effectively to achieve the related control objectives stated in the description, throughout the period [*date*] to [*date*].

An audit of a description of a service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of those controls to achieve the related control objectives stated in the description. Our procedures included assessing the risks that the description is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives stated in the description. Our procedures also included testing the operating effectiveness of those controls that we consider necessary to provide reasonable assurance that the related control objectives stated in the description were achieved. An audit engagement of this type also includes evaluating the overall presentation of the description and the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page [*aa*]. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Inherent limitations

Because of their nature, controls at a service organization may not prevent or detect and correct all errors or omissions in processing or reporting transactions [*or identification of the function performed by the system*]. Also, the projection to the future of any evaluation of the fairness of the presentation of the description, or conclusions about the suitability of the design or operating effectiveness of the controls to achieve the related control objectives is subject to the risk that controls at a service organization may become inadequate or fail.

Opinion

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion on page [aa]

- a. the description fairly presents the [*type or name of*] system that was designed and implemented throughout the period [*date*] to [*date*].
- b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period [*date*] to [*date*].
- c. the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period [*date*] to [*date*].

Description of tests of controls

The specific controls tested and the nature, timing, and results of those tests are listed on pages [yy–zz].

Restricted use

This report and the description of tests of controls and results thereof on pages [yy–zz] are intended solely for the information and use of XYZ Service Organization, user entities of XYZ Service Organization's [*type or name of*] system during some or all of the period [*date*] to [*date*], and the independent auditors of such entities, who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements. This report is not intended to be and should not be used by anyone other than these specified parties.

[*Service auditor's signature*]

[*Date of the service auditor's report*]

[*Service auditor's address*]

Following is a modification of the scope paragraph in a type 2 service auditor's report if the description refers to the need for complementary user entity controls. (New language is shown in boldface italics):

We have audited XYZ Service Organization's description of its [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [*date*] to [*date*] (description) and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description. ***The description indicates that certain control objectives specified in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with related controls at the service organization. We have not evaluated the suitability of the design or operating effectiveness of such complementary user entity controls.***

Following is a modification of the applicable subparagraphs of the opinion paragraph of a type 2 service auditor's report if the application of complementary user entity controls is necessary to achieve the

control objectives stated in the description of the service organization's system (New language is shown in boldface italics):

- b. The controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively throughout the period [date] to [date] **and user entities applied the complementary user entity controls contemplated in the design of XYZ Service Organization's controls throughout the period [date] to [date].**
- c. The controls we tested, which were those necessary to provide reasonable assurance that the related control objectives stated in the description were achieved, operated effectively throughout the period [date] to [date] **if user entities applied the complementary user entity controls contemplated in the design of XYZ Service Organization's controls throughout the period [date] to [date].**

Following is a modification of the paragraph that describes the responsibilities of management of the service organization for use in a type 2 service auditor's report when the control objectives have been specified by an outside party. (New language is shown in boldface italics):

On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for its assertion, including the completeness, accuracy, and method of presentation of the description and assertion, providing the services covered by the description, selecting the criteria, and designing, implementing, and documenting controls to achieve the control objectives stated in the description. **The control objectives have been specified by [name of party specifying the control objectives] and are stated on page [aa] of the description.**

Example 2: Type 1 Service Auditor's Report

Independent Service Auditor's Report on a Description of a Service Organization's System and the Suitability of the Design of Controls

To: XYZ Service Organization

Scope

We have audited XYZ Service Organization's description of its [type or name of] system for processing user entities' transactions [or identification of the function performed by the system] as of [date], and the suitability of the design of controls to achieve the related control objectives stated in the description.

Service organization's responsibilities

On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design of the controls to achieve the related controls objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for its assertion, including the completeness, accuracy, and method of presentation of the description and the assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Service auditor's responsibilities

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design of the controls to achieve the related control objectives stated in the

description, based on our audit. We conducted our audit in accordance with the Canadian Standard on Assurance Engagements for Reporting on Controls at a Service Organization, set out in the CICA Handbook – Assurance. This standard requires that we plan and perform our audit to obtain reasonable assurance, in all material respects, about whether the description is fairly presented and the controls were suitably designed to achieve the related control objectives stated in the description as of [date].

An audit of a description of a service organization's system and the suitability of the design of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description of the system and the suitability of the design of the controls to achieve the related control objectives stated in the description. Our procedures included assessing the risks that the description is not fairly presented and that the controls were not suitably designed to achieve the related control objectives stated in the description. An audit engagement of this type also includes evaluating the overall presentation of the description and the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page [aa].

We did not perform any procedures regarding the operating effectiveness of the controls stated in the description and, accordingly, do not express an opinion thereon.

We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Inherent limitations

Because of their nature, controls at a service organization may not prevent or detect and correct all errors or omissions in processing or reporting transactions [or *identification of the function performed by the system*]. The projection to the future of any evaluation of the fairness of the presentation of the description, or any conclusions about the suitability of the design of the controls to achieve the related control objectives is subject to the risk that controls at a service organization may become ineffective or fail.

Opinion

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion

- a. the description fairly presents the [type or name of] system that was designed and implemented as of [date], and
- b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively as of [date].

Restricted use

This report is intended solely for the information and use of XYZ Service Organization, user entities of XYZ Service Organization's [type or name of] system as of [date], and the independent auditors of such user entities, who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves, when obtaining an understanding of user entities information and communication systems relevant to financial reporting. This report is not intended to be and should not be used by anyone other than these specified parties.

[Service auditor's signature]

[Date of the service auditor's report]

[Service auditor's address]

Following is a modification of the scope paragraph in a type 1 report if the description of the service organization's system refers to the need for complementary user entity controls. (New language is shown in boldface italics)

We have audited XYZ Service Organization's description of the [type or name of] system (description) made available to user entities of the system for processing their transactions [or identification of the function performed by the system] as of [date], and the suitability of the design of controls to achieve the related control objectives stated in the description. ***The description indicates that certain complementary user entity controls must be suitably designed and implemented at user entities for related controls at the service organization to be considered suitably designed to achieve the related control objectives. We have not evaluated the suitability of the design or operating effectiveness of such complementary user entity controls.***

Following is a modification of the applicable subparagraph in the opinion paragraph of a type 1 report if the application of complementary user entity controls is necessary to achieve the control objectives stated in management's description of the service organization's system (New language is shown in boldface italics):

b. The controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively as of [date] ***and user entities applied the complementary user entity controls contemplated in the design of XYZ Service Organization's controls as of [date].***

Following is a modification of the paragraph that describes management of XYZ Service Organization's responsibilities to be used in a type 1 report when the control objectives have been specified by an outside party. (New language is shown in boldface italics):

On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and assertion, including the completeness, accuracy, and method of presentation of the description and assertion, providing the services covered by the description, selecting the criteria, and designing, implementing, and documenting controls to achieve the control objectives stated in the description. ***The control objectives have been specified by [name of party specifying the control objectives] and are stated on page [aa] of the description.***

Illustrative Modified Service Auditor's Reports

The following examples of modified service auditors' reports are for guidance only and are not intended to be exhaustive or applicable to all situations. They are based on the illustrative reports in Appendix 1.

Example 1: Qualified opinion for a type 2 report—the description of the service organization's system is not fairly presented in all material respects

[The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.]

Basis for qualified opinion

The accompanying description states on page [mn] that XYZ Service Organization uses operator identification numbers and passwords to prevent unauthorized access to the system. Based on inquiries of staff personnel and observation of activities, we have determined that operator identification numbers and passwords are employed in applications A and B but are not required to access the system in applications C and D.

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page [aa], in all material respects....

Example 2: Qualified opinion—the controls are not suitably designed to provide reasonable assurance that the control objectives stated in the description of the service organization's system would be achieved if the controls operated effectively

[The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.]

Basis for qualified opinion

As discussed on page [mn] of the accompanying description, from time to time, XYZ Service Organization makes changes in application programs to correct deficiencies or to enhance capabilities. The procedures followed in determining whether to make changes, in designing the changes, and in implementing them do not include review and approval by authorized individuals who are independent from those involved in making the changes. There are also no specified requirements to test such changes or provide test results to an authorized reviewer prior to implementing the changes. As a result the controls are not suitably designed to achieve the control objective, "Controls provide reasonable assurance that changes to existing applications are authorized, tested, approved, properly implemented, and documented."

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page [aa], in all material respects...

Example 3: Qualified opinion for a type 2 report—the controls did not operate effectively throughout the specified period to achieve the control objectives stated in the description of the service organization's system

[The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.]

Basis for qualified opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the various output reports. However, as noted on page [mn] of the description of tests of controls and results thereof, this control was not operating effectively throughout the period [date] to [date] due to a programming error. This resulted in the nonachievement of the control objective, "Controls provide reasonable assurance that loan payments received are properly recorded" throughout the period January 1, 20X1 to April 30, 20X1. XYZ Service Organization implemented a change to the program performing the calculation as of May 1, 20X1, and our tests indicate that it was operating effectively throughout the period May 1, 20X1 to December 31, 20X1.

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page [aa], in all material respects....

Example 4: Qualified opinion— the service auditor is unable to obtain sufficient appropriate evidence

[The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.]

Basis for qualified opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the output generated. However, electronic records of the performance of this reconciliation for the period from [date] to [date] were deleted as a result of a computer processing error and, therefore, we were unable to test the operation of this control for that period. Consequently, we were unable to determine whether the control objective, "Controls provide reasonable assurance that loan payments received are properly recorded" was achieved throughout the period [date] to [date].

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page [aa], in all material respects...

Illustrative Report Paragraphs for Service Organizations That Use a Subservice Organization

Following are modifications of the illustrative type 2 report in Example 1 of Appendix 1 for use in engagements in which the service organization uses a subservice organization.

New language is shown in boldface italics; deleted language is shown by strikethrough.

Example 1: Carve-out method

Scope

We have audited XYZ Service Organization's description of its system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [date] to [date] (description) and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description.

XYZ Service Organization uses a computer processing service organization for all of its computerized application processing. The description on pages [bb–cc] includes only the controls and related control objectives of XYZ Service Organization and excludes the control objectives and related controls of the computer processing service organization. Our audit did not extend to controls of the computer processing service organization.

All other report paragraphs are unchanged.

Example 2: Inclusive Method

Scope

We have audited XYZ Service Organization's ***and ABC Subservice Organization's*** description of their [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [date] to [date] (description) and the suitability of the design and operating effectiveness of ***XYZ Service Organization's and ABC Subservice Organization's*** controls to achieve the related control objectives stated in the description. ***ABC Subservice Organization is an independent service organization that provides computer processing services to XYZ Service Organization. XYZ Service Organization's description includes a description of ABC Subservice Organization's [type or name of] system used by XYZ Service Organization to process transactions for its user entities, as well as relevant control objectives and controls of ABC Subservice Organization.***

XYZ Service Organization's responsibilities

On page XX of the description, XYZ Service Organization ***and of ABC Subservice Organization*** ***has*** ~~have~~ provided ~~an~~ their assertions about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization ***and of ABC Subservice Organization*** ~~are~~ ***are*** responsible for preparing the description and assertions, including the completeness, accuracy, and method of presentation of the description and assertions, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Inherent limitations

Because of their nature, controls at a service organization ***or subservice organization*** may not prevent or detect and correct all errors or omissions in processing or reporting transactions. Also, the projection to the future of any evaluation of the fairness of the presentation of the description or any conclusions about

the suitability of the design or operating effectiveness of the controls to achieve the related control objectives is subject to the risk that controls at a service organization **or subservice organization** may become ineffective or fail.

Opinion

In our opinion, in all material respects, based on the criteria specified in XYZ Service Organization's and ABC Subservice Organization's assertions on page [aa],

- a. the description fairly presents **XYZ Service Organization's** the [type or name of] system **and ABC Subservice Organization's** [type or name of] system used by XYZ Service Organization to process transactions for its user entities that ~~were~~ was designed and implemented throughout the period [date] to [date], and
- b. the controls related to the control objectives **of XYZ Service Organization and ABC Subservice Organization** stated in the description were suitably designed to provide reasonable assurance that those control objectives stated in the description were achieved if the controls operated effectively throughout the period [date] to [date].
- c. the controls **of XYZ Service Organization and ABC Computer Processing Service Organization that** we tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period [date] to [date].

All other report paragraphs are unchanged.

Illustrative Assertions by Management of a Service Organization

The assertion by management of the Service Organization may be included in management's description of the service organization's system or may be attached to the description. The following illustrative assertions are intended for assertions that are included in the description.

The following illustrative management assertions are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Assertion by Management of a Service Organization for a Type 2 Report

XYZ Service Organization's Assertion

We have prepared the description of XYZ Service Organization's [*type or name of*] system (description) for user entities of the system during some or all of the period [*date*] to [*date*], and their user auditors who have a sufficient understanding to consider it, along with other information, including information about controls implemented by user entities of the system themselves, when assessing the risks of material misstatements of user entities' financial statements. We confirm, to the best of our knowledge and belief, that:

- (a) The description fairly presents the [*type or name of*] system made available to user entities of the system during some or all of the period [*date*] to [*date*] for processing their transactions [*or identification of the function performed by the system*]. The criteria we used in making this assertion were that the description:
 - (i) Presents how the system made available to user entities of the system was designed and implemented to process relevant transactions, including:
 - The classes of transactions processed.
 - The procedures, within both automated and manual systems, by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports presented to user entities of the system.
 - The related accounting records, supporting information, and specific accounts that are used to initiate, authorize, record, process, and report transactions; this includes the correction of incorrect information and how information is transferred to the reports presented to user entities of the system.
 - How the system captures and addresses significant events and conditions, other than transactions.
 - The process used to prepare reports or other information provided to user entities' of the system.
 - Specified control objectives and controls designed to achieve those objectives.
 - Other aspects of our control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls that are relevant to processing and reporting transactions of user entities of the system.

- (ii) Does not omit or distort information relevant to the scope of the [*type or name of*] system, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities of the system and the independent auditors of those user entities, and may not, therefore, include every aspect of the [*type or name of*] system that each individual user entity of the system and its auditor may consider important in its own particular environment.
- (b) The description includes relevant details of changes to the service organization's system during the period covered by the description when the description covers a period of time.
 - (c) The controls related to the control objectives stated in the description were suitably designed and operated effectively throughout the period [*date*] to [*date*] to achieve those control objectives. The criteria we used in making this assertion were that:
 - (i) The risks that threaten the achievement of the control objectives stated in the description have been identified by the service organization;
 - (ii) the controls identified in the description would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved; and
 - (iii) the controls were consistently applied as designed, including whether manual controls were applied by individuals who have the appropriate competence and authority.

Example 2: Assertion by Management of a Service Organization for a Type 1 Report

XYZ Service Organization's Assertion

We have prepared the description of XYZ Service Organization's [*type or name of*] system (description) for user entities of the system as of [*date*], and their user auditors who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves, when obtaining an understanding of user entities' information and communication systems relevant to financial reporting. We confirm, to the best of our knowledge and belief, that:

- (a) The description, fairly presents the [*type or name of*] system made available to user entities of the system as of [*date*] for processing their transactions [*or identification of the function performed by the system*]. The criteria we used in making this assertion were that the description:
 - (i) Presents how the system made available to user entities of the system was designed and implemented to process relevant transactions, including:
 - The classes of transactions processed.
 - The procedures, within both automated and manual systems, by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports presented to user entities of the system.
 - The related accounting records, supporting information, and specific accounts that are used to initiate, authorize, record, process, and report transactions; this includes the correction of incorrect information and how information is transferred to the reports provided to user entities of the system.
 - How the system captures and addresses significant events and conditions, other than transactions.

- The process used to prepare reports or other information provided to user entities of the system.
 - Specified control objectives and controls designed to achieve those objectives.
 - Other aspects of our control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls that are relevant to processing and reporting transactions of user entities of the system.
- (ii) Does not omit or distort information relevant to the scope of the [*type or name of*] system, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities of the system and the independent auditors of those user entities, and may not, therefore, include every aspect of the [*type or name of*] system that each individual user entity of the system and its auditor may consider important in its own particular environment.
- (d) The controls related to the control objectives stated in the description were suitably designed as of [*date*] to achieve those control objectives. The criteria we used in making this assertion were that:
- (i) The risks that threaten the achievement of the control objectives stated in the description have been identified by the service organization.
 - (ii) The controls identified in the description would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.

CONFORMING AMENDMENTS

Section 5925, AN AUDIT OF INTERNAL CONTROL OVER FINANCIAL REPORTING THAT IS INTEGRATED WITH AN AUDIT OF FINANCIAL STATEMENTS

The placement of the inherent limitations paragraph will be changed as follows:

82. The report on the audit of internal control over financial reporting shall include the following elements:
- ...
- (k) A paragraph stating that, because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements and that projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate;
- (kl) Under a section with the heading "Opinion", the auditor's opinion on whether the entity maintained, in all material respects, effective internal control over financial reporting as at the specified date, in accordance with the control criteria;
- ~~(l) A paragraph stating that, because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements and that projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate;~~
- ...
- A82. The following example report expressing an unqualified opinion on internal control over financial reporting illustrates the report elements described in this Section.

INDEPENDENT AUDITOR'S REPORT

.....

(Inherent limitations paragraph)

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion

In our opinion, the entity maintained, in all material respects, effective internal control over financial reporting as at December 31, 20X0, in accordance with [identify control criteria, for example, "criteria established in "Guidance on Control" (CoCo Framework) published by The Canadian Institute of Chartered Accountants or "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."].

~~(Inherent limitations paragraph)~~

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.