

BASIS FOR CONCLUSIONS CANADIAN STANDARD ON ASSURANCE ENGAGEMENTS (CSAE) 3416, Reporting on Controls at a Service Organization

August 2010

This Basis for Conclusions has been prepared by staff of the Auditing and Assurance Standards Board (AASB). It relates to, but does not form part of, Canadian Standard on Assurance Engagements 3416, *Reporting on Controls at a Service Organization*.

Purpose of this Basis for Conclusions

This Basis for Conclusions provides a brief summary of the AASB's objectives in developing CSAE 3416, the public exposure and approval steps for this project and how the AASB dealt with significant matters arising from comments received in response to its Exposure Draft of the CSAE. This information is set out below.

Background

In September 2009 the AASB commenced a project to develop a new CSAE in response to projects undertaken by other jurisdictions to develop or revise corresponding similar assurance standards. The International Auditing and Assurance Board (IAASB) developed and issued International Standard on Assurance Engagements (ISAE) 3402, *Reporting on Controls at a Service Organization* and the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued its Statement on Standards for Attestation Engagements (SSAE) 16, *Reporting on Controls at a Service Organization*. SSAE 16 replaces the extant Statement on Auditing Standards (SAS) 70, *Service Organizations*.

In March 2010, the AASB issued an Exposure Draft (ED CSAE 3416) proposing to replace Section 5970, AUDITOR'S REPORT ON CONTROLS AT A SERVICE ORGANIZATION, and former AuG-42, Service Organizations that Use Other Service Organizations. The AASB had aligned Section 5970 and AuG-42 with SAS 70 because the marketplace for these types of engagements is highly integrated between the Canadian and US markets. Both Section 5970 and SAS 70 are extensively used in Canada. In February 2008, the AASB issued an Invitation to Comment and received input from stakeholders who expressed a strong desire to continue to align the proposed CSAE with the corresponding US standard.

There were 3 respondents to ED CSAE 3416 (identified below).

The Auditing and Assurance Standards Oversight Council concluded that the AASB followed due process in developing this Section prior to its issuance in the CICA Handbook – Assurance.

AASB's Objectives in Developing CSAE 3416

The AASB's objective was to develop a Canadian Standard on Assurance Engagements equivalent to SSAE 16, making only minimal amendments to the wording of the SSAE to:

- (a) avoid any inconsistency with Other Canadian Standards; or
- (b) address circumstances particular to the Canadian environment where amendments are required to serve the Canadian public interest and maintain the quality of auditing and reporting in Canada.

SSAE 16 was developed by the AICPA using ISAE 3402 and amended to meet the needs of the US environment. By aligning with the SSAE, CSAE 3416 would also align with ISAE 3402 in most respects. The AICPA Audit and Attest Standards staff prepared an analysis to highlight substantive differences between the final SSAE 16 and ISAE 3402. The analysis is not authoritative and was prepared for information purposes only (see [Appendix 1](#)).

The following is a summary of the amendments made to the SSAE wording in finalizing CSAE 3416. The AASB concluded that even after these amendments, CSAE 3416 is aligned with SSAE 16 in all material respects.

(a) Framework

SSAE 16 is based on, and contains a number of references to, AT Section 101, *Attest Engagements*, which is the framework standard that covers all US attestation engagements. In Canada, Section 5025, STANDARDS FOR ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION, establishes the framework and includes Recommendations for all assurance engagements, other than audits of financial statements and other historical financial information. Therefore, in developing CSAE 3416, changes were made to ensure consistency with Section 5025.

(b) Cross-references to auditing standards

The AASB determined that this 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, in SSAE 16, the AICPA elected to refer directly to financial statement auditing standards in its requirements rather than include the relevant material within the SSAE.

Where SSAE 16 contains references to an auditing standard in a requirement, CSAE 3416 has replaced that reference with the corresponding relevant material extracted from ISAE 3402 with the following exceptions:

Direct assistance

The SSAE requires the service auditor 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. ISAE 3402 does not address this matter. In CSAE 3416, the SSAE requirement has been replaced with the relevant recommendation in Section 5050, USING THE WORK OF INTERNAL AUDIT IN ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OF FINANCIAL STATEMENTS AND OTHER HISTORICAL FINANCIAL INFORMATION.

Subsequent events

The 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 in [Appendix 1](#), ISAE 3402 does not contain a similar requirement. The AASB determined that CSAE 3416 should not require the service auditor to adapt and apply the requirements in CAS 560, *Subsequent Events*, for the reasons stated above. In CSAE 3416, the reference to AU 561 has been replaced with a requirement to "respond appropriately to such facts." The AASB determined that guidance on this matter is desirable. Therefore, in the application and explanatory material in CSAE 3416, the service auditor may consider the guidance in CAS 560 in determining an appropriate response, but is not required to adapt and apply CAS 560.

(c) Effective Date

The effective date of CSAE 3416 is for service auditors' reports for periods ending on or after December 15, 2011, with earlier implementation permitted.

The effective date for the SSAE 16 (and ISAE 3402) is for periods ending on or after June 15, 2011, with earlier implementation permitted.

The AASB acknowledges that if Section 5970 could no longer be used for periods ending on or after June 15, 2011, there might not be sufficient time for Canadian practitioners to transition to CSAE 3416. Therefore, the AASB concluded that an effective date of December 15, 2011 would be appropriate. During the period between the respective effective dates of June 15, 2011 and December 15, 2011, any reports issued under Section 5970 will not be aligned with reports that will be issued under SSAE 16. However, early implementation of CSAE 3416 is allowed so that service auditors will be able to achieve alignment, if they so desire.

Significant Matters Arising from Comments in Response to ED CSAE 3416

In light of the AASB's objective to align CSAE 3416 as closely as possible with the SSAE 16, stakeholders were requested to identify any unique Canadian circumstances with respect to the proposed requirements of the CSAE that would warrant a modification in the wording. The following discussion presents the AASB's consideration of amendments to SSAE 16 wording:

Controls Other than Financial Controls

1. Two respondents stated that the scope of CSAE 3416 should be expanded to include reporting on controls other than those that are likely to be relevant to user entities' financial reporting. In the view of these respondents, there is a demand for such services but no standard that provides sufficient guidance to the practitioner. Their belief is that CSAE 3416 could be used for other types of engagements.
2. CSAE 3416 (like ISAE 3402 and SSAE 16) 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. Paragraph 2 of CSAE 3416 states that the guidance may be helpful to a practitioner in performing engagements to report on controls other than financial controls. However, such engagements are performed under Section 5025 and are excluded from the scope of CSAE 3416. There could be a wide variety of services and controls that a service auditor could be asked to report on. Guidance is provided in paragraph A3 to highlight some of the issues that a service auditor may encounter and need to address in other engagements that differ significantly from an engagement to report on financial controls.
3. The AASB concluded that no change should be made to the scope of CSAE 3416. The AASB concurs with the IAASB and the AICPA's ASB in restricting the use and focus of CSAE 3416 to engagements to report on controls that are likely to be relevant to user entities' financial reporting. However, the AASB acknowledges there may be a need for a separate CSAE to provide guidance to practitioners when reporting on other controls. A decision to undertake a project to develop a new CSAE would be dependent on what priority should be given to such a project and availability of resources.

Assertion-based Engagements

4. CSAE 3416 is based on the premise that management of the service organization 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. The purpose of requiring the written assertion is to reinforce that it is management who is responsible for the description of the system, the design of the system and, where applicable to the engagement, the operating effectiveness of the controls. The service auditor can only accept or continue an engagement under CSAE 3416 if management agrees to provide such an assertion and has a reasonable basis for its assertion.
5. A respondent expressed concern that CSAE 3416 did not contain sufficient guidance regarding the service auditor's responsibilities for assessing that management has a reasonable basis for their assertion.
6. In developing ISAE 3402 (SSAE 16 and, consequently, CSAE 3416) there was no intent to unduly burden management with additional activities in providing the assertion. Paragraph A17 indicates that there may not be extra effort required by management as their ongoing monitoring activities may provide sufficient evidence to the service auditor that there is a reasonable basis for their assertion. The service auditor will be testing the monitoring controls as part of the engagement.
7. Similar assertions are provided in the written representation letter in the performance of the service audit under Section 5970 (or SAS 70). In providing a representation letter, management required a basis for making the representations. In CSAE 3416, the difference is that management's assertions are publicly available. The service auditor's responsibilities regarding the basis upon which management makes its assertions are similar, regardless of whether the assertions are in a representation letter or in the written assertion that is made publicly available.
8. The AASB concluded that no additional guidance regarding this matter is required in CSAE 3416. Further, this matter does not present an issue unique to the Canadian environment that warrants amendments to the wording of SSAE 16 in drafting CSAE 3416.
Suitable Criteria
9. Section 5025 is the assurance framework standard that applies to all assurance engagements. It states that for the practitioner to undertake the assurance engagement there must be suitable criteria for evaluating the subject matter. CSAE 3416 contains requirements for assessing the suitability of criteria used by management and also provides the minimum elements of suitable criteria in order to establish consistency when applying the standard.
10. A respondent questioned whether the criteria discussed in CSAE 3416 meet the characteristics of suitable criteria as provided in Section 5025.
11. The topic of "suitable criteria", and whether to include any examples within the standard, was discussed extensively in the development of ISAE 3402 and SSAE 16. Suitable criteria are determined for each engagement. They will be customized and user defined. Given the wide variety of services and controls that may be the subject of the engagement, it was concluded that general criteria, at a very high level, would be appropriate as it allows the standard to be flexible, rather than attempt to specify criteria that would be suitable for every type of engagement.
12. The IAASB developed the minimum elements of suitable criteria identified in ISAE 3402 so that they have the characteristics required by the *International Framework for Assurance Engagements*. Similarly, the AICPA ASB concluded that the examples of suitable criteria in SSAE 16 have the characteristics for such criteria required by AT 101, *Attest Engagements*.
13. The characteristics of suitable criteria, as described in Section 5025, are consistent with those set out in the *International Framework for Assurance Engagements* and AT 101. The AASB concluded that this matter does not present an issue unique to the Canadian environment and has made no amendments to the wording of SSAE 16 in drafting CSAE 3416.
Inclusive Method (Subservice Organizations)
14. CSAE 3416 provides requirements and application and other explanatory material to deal with situations where the service organization uses another service organization (a subservice organization).
15. If the "inclusive method" is used, all services of the subservice organization are within the scope of the service auditor's engagement under CSAE 3416. The requirements of the CSAE apply equally to the subservice organization and the service auditor is fully responsible for opining on all information about the subservice organization that is included in the description.
16. A respondent noted that the guidance is silent on situations where the inclusive method is used and where the subservice organization provides a service auditor's report (subservice auditor's report). The respondent suggested that guidance be added to include consideration of the service auditor's use of the subservice auditor's report as a basis for using the inclusive method of reporting.
17. The service auditor may obtain a subservice auditor's report as one piece of evidence but that would unlikely be the sole basis for using the inclusive method; other audit procedures at the subservice organization would normally be required. The nature, timing and extent of the audit procedures performed would be dependent on the service auditor's risk assessment related to the nature and extent of services provided by the subservice organization. This is an example of how to implement the inclusive method. The AASB concluded that this matter does not present an issue unique to the Canadian environment and has made no amendments to the wording of SSAE 16 in drafting CSAE 3416.

List of Respondents to ED CSAE

Appendix 1

Comparison of Requirements of Statement on Standards for Attestation Engagements No. 16, *Reporting On Controls at a Service Organization*, with Requirements of International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization* 1

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between Statement on Standards for Attestation Engagements (SSAE) No. 16, *Reporting on Controls at a Service Organization* (AICPA, *Professional Standards*, vol. 1), and International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*, and to explain the rationale for those differences. This analysis is not authoritative and is prepared for informational purposes only.

1. Intentional Acts by Service Organization Personnel

Paragraph 26 of the SSAE requires the service auditor to investigate the nature and cause of any deviations identified, as does paragraph 28 of ISAE 3402. Paragraph 27 of the SSAE indicates that if the service auditor becomes aware that the deviations resulted from intentional acts by service organization personnel, the service auditor should assess the risk that the description of the service organization's system is not fairly presented and that the controls are not suitably designed or operating effectively. The ISAE does not contain the requirement included in paragraph 27 of the SSAE. The Auditing Standards Board (ASB) believes that information about intentional acts affects the nature, timing, and extent of the service auditor's procedures. Therefore, paragraph 27 provides follow-up action for the service auditor when he or she obtains information about intentional acts as a result of performing the procedures in paragraph 26 of the SSAE.

Paragraph 36(c)(ii) of the SSAE, which is not included in ISAE 3402, also requires the service auditor to request written representations from management that it has disclosed to the service auditor knowledge of any actual, suspected, or alleged intentional acts by management or the service organization's employees, of which it is aware, that could adversely affect the fairness of the presentation of management's description of the service organization's system or the completeness or achievement of the control objectives stated in the description.

2. Anomalies

Paragraph 29 of ISAE 3402 contains a requirement that enables a service auditor to conclude that a deviation identified in tests of controls involving sampling is not representative of the population from which the sample was drawn. The SSAE does not include this requirement because of concerns about use of terms such as, "in the extremely rare circumstances" and "a high degree of certainty." These terms are not used in U.S professional standards and the ASB believes their introduction in the SSAE could have unintended consequences. The ASB also believes that the deletion of this requirement will enhance examination quality because deviations identified by the service auditor in tests of controls involving sampling will be treated in the same manner as any other deviation identified by the practitioner, rather than as an anomaly.

3. Direct Assistance

Paragraph 35 of the SSAE requires the service auditor to adapt and apply the requirements in paragraph .27 of AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1), when the service auditor uses members of the service organization's internal audit function to provide direct assistance. Because AU section 322 provides for an auditor to use the work of the internal audit function in a direct assistance capacity, paragraph 35 of the SSAE also provides for this. The International Standards on Auditing and the ISAEs do not provide for use of the internal audit function for direct assistance.

4. Subsequent Events

With respect to events that occur subsequent to the period covered by the description of the service organization's system up to the date of the service auditor's report, paragraph 42 of the SSAE requires the service auditor to disclose in the service auditor's report, if not disclosed by management in its description, any event that is of such a nature and significance that its disclosure is necessary to prevent users of a type 1 or type 2 report from being misled. The ASB believes that information about such events could be important to user entities and their auditors. ISAE 3402 limits the types of subsequent events that would need to be disclosed in the service auditor's report to those that could have a significant effect on the service auditor's report.

Paragraph 43 of the SSAE requires the service auditor to adapt and apply the guidance in AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1) 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. The ISAE does not include a similar requirement. The ASB believes that, by analogy, AU section 561 provides needed guidance to a service auditor by presenting the various circumstances that could occur during the subsequent events period and the actions a service auditor should take.

5. Statement Restricting Use of the Service Auditor's Report

The SSAE requires the service auditor's report to include a statement restricting the use of the report to management of the service organization, user entities of the service organization's system, and user auditors. The ASB believes that the unambiguous language in the restricted use statement prevents misunderstanding regarding who the report is intended for. Paragraphs A61–A62 of the SSAE explain the reasons for restricting the use of the report. ISAE 3402 requires the service auditor's report to include a statement indicating that the report is intended only for user entities and their auditors. However, the ISAE does not require the inclusion of a statement restricting the use of the report to specified parties, although it does not prohibit the inclusion of restricted use language in the report.

6. Documentation Completion

Paragraph 50 of the ISAE requires the service auditor to assemble the 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 assurance report. Paragraph 49 of the SSAE also requires the service auditor to assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis, but also indicates that a timely basis is no later than 60 days following the service auditor's report release date. The ASB made this change to parallel the definition of *documentation completion date* in paragraph .27 of AU section 339, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1).

7. Engagement Acceptance and Continuance

Paragraph 9 of the SSAE establishes conditions for the acceptance and continuance of an engagement to report on controls at a service organization. One of the conditions is that management acknowledges and accepts responsibility for providing the service auditor with written representations at the conclusion of the engagement. ISAE 3402 does not include this requirement as a condition of engagement acceptance and continuance.

8. Disclaimer of Opinion

If management does not provide the service auditor with certain written representations, paragraph 40 of ISAE 3402 requires the service auditor, after discussing the matter with management, to disclaim an opinion. In the same circumstances, paragraph 39 of the SSAE requires the service auditor to take appropriate action, which may include disclaiming an opinion or withdrawing from the engagement.

Paragraphs 56 and 57 of the SSAE contain certain incremental requirements when the service auditor plans to disclaim an opinion.

9. Elements of the SSAE Report That Are Not Required in the ISAE 3402 Report.

Paragraphs 52 and 53 of the SSAE contain certain requirements regarding the content of the service auditor's report, which are incremental to those in ISAE 3402. These incremental requirements are included in paragraphs (52)(c)(iii); 52(e)(iv); (52)(i); and 52(k) for type 2 reports, and in paragraphs (53)(c)(iii); 53(e)(iv); (53)(j); and 53(k) for type 1 reports.

Footnotes

1. Statement on Standards for Attestation Engagements Issued by the Auditing Standards Board No. 16, Reporting on Controls at a Service Organization, March 2010, Paragraph A72, Exhibit B.

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