

Nahata Professional Academy Presents

SEMINAR ON CHANGES AND UPDATES IN

ADVANCED AUDITING

(More than 30 updates / changes which
everyone should know)

Incorporating amendments applicable to May/November
2012 CA final Exam under the topics of CODE OF ETHICS
AUDIT UNDER COMPANIES ACT ACCOUNTING
STANDARDS.

(All these amendments are appeared in ICAI Journal or WEBSITE from time to time
since last 8 months)

Dear students,

As promised you in the batch, I m Here with the memorandum of changes /updates since my last batch (ended on 14th September 2011) please make the amendment at suitable places in your books provided to you. These changes are notified by Council of ICAI, ESB, MCA, AASB,ASB. Kindly go through these and enjoy learning.

Always with you @ the speed of changes...

Thank you



AseemTrivedi



HM Update -1(COE)

In the definition of Management Consultancy Services it included acting as e-Return Intermediary comes within "Management Consultancy and Other Services" hence it is permissible.

HM update-2(COE)

A number of Chartered Accountants Societies or other bodies are creating data-bases of Chartered Accountants or Chartered Accountants' Firms (like Bombay Chartered Accountants Society) and are offering listing to Chartered Accountants. Such listing would be permitted with or without payment. In case a Chartered Accountant or Chartered Accountants' Firm is a member of a professional body or association or Chamber of Commerce and they offer listing to the members or firm, the same would be permitted."

HM Update -3(COE)

Committee on ethical standards, allowed the use of 'Dr.' with the designation 'CA'. It is left to the discretion of member. Whether to use 'CA' first, or 'Dr. first, or use 'Dr.' only before the name of the member.

HM update -4(COE)

Whether an Independent Director can sign the financial statements of the company despite he is practicing CA.?

A CA in practice can be a 'Director Simplicitor', which includes an independent director. The independent directors are part of the Board where the Accounts are approved, they being party to approval of financial statement. A CA who is director (Independent) can sign the financial statement. However, he cannot be involved in the day to day affairs of the company.

HM Update - 5(COE)

Chapter IV Opinion on financial statements when there is substantial interest :-As per new guidelines amended on 28th June 2011 A member of the Institute should not express his opinion on financial statements of any business or enterprise in which one or more persons who are his "relatives" within the meaning of Accounting Standard (AS - 18) has / have, either by themselves or in conjunction with such member, a substantial interest in the said business or enterprise. Where substantial interest means :-

- I) A member shall be deemed to have a "substantial interest" in a concern-



- (a) In a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of voting power at any time, during the relevant years are owned beneficially by such member or by any one or more of the following persons or partly by such member and partly by one or more of the following persons:
- (i) One or more relatives of the member ;
 - (ii) Any concerns in which any of the persons referred to above has a substantial interest ;
- (b) In the case of any other concern, if such member is entitled or the other persons referred to above or such member and one or more of the other persons referred to above are entitled in the aggregate , at any time during the relevant years to not less than twenty per cent of the profits of such concern.

HM update -6 (COE)

Chapter-XII (Minimum Audit Fee in respect of Audit) of the Council General Guidelines, 2008 appended to the ICAI publication titled “ The Chartered Accountants Act, 1949” has been repealed with effect from 7th June, 2011.hence now there are no guidelines at present for minimum fee.

HM Update-7(COE)

Announcement of KYC Norms shall be recommendatory in nature, and apply only in case of attest function.

KNOW YOUR CLIENT (KYC) NORMS

The financial services industry globally is required to obtain information of their clients and comply Know Your Client Norms (KYC norms).

Keeping in mind the highest standards of Chartered Accountancy profession in India, the Council of ICAI thought it necessary to recommend such norms to be observed by the members of the profession who are in practice.

In light of this background, the Council of ICAI approved the following KYC Norms. However, these norms are recommendatory in nature and every Chartered Accountant carrying out attest function is encouraged to follow them.

1. ENTITY INFORMATION

A. GENERAL INFORMATION

- ☐ Name of the Entity
- ☐ Type of Entity
- ☐ Business Description

B. CORPORATE STRUCTURE

- ☐ Name of ultimate parent company
- ☐ Name of Parent company
- ☐ Name of Affiliates

C. REGULATORY INFORMATION

- ☐ Company PAN No



- ☐ Company Identification No
- ☐ Directors' Identification No
- ☐ Directors' Names & Addresses
- ☐ Name(s) and Addresses of Companies, in which above person is director.

D. ENGAGEMENT INFORMATION

- ☐ Type of Engagement

2. OTHER INFORMATION

- ☐ Entities financial Information
- ☐ Name of the ultimate parent Auditor
- ☐ Any known violation of any Law/Regulations (Effect from 13th July, 2011)

HM Update -8(COE)

The Committee on Ethical Standards, decided that it is not permissible for a member who has been Director of a Company, upon resignation from the Company to be appointed as an auditor of the said Company, and the cooling period for the same may be 2 years.

HM Update - 9 (COE)

Whether a blind Chartered Accountant with CoP can sign "General Purpose Financial Statements" or carry out "other attest functions". The Board, while approving most of the recommendations of the Study Group, has concluded that the same is permissible.

Important decisions of the Ethical Standards Board in 2010-11

HM Update -10 (COE)

Transfer Pricing certification Services are permissible for an Auditor of an entity as it is only a certification work and not an audit, and the issue of independence is not involved .

HM Update - 11(COE)

Consultancy work is permissible with the assignment of internal audit.

HM Update - 12(COE)

Interference with the practices prevailing for requirement of EMD/Deposit is not required. However, any specific complaint in this regard may be examined by the office.



HM Update - 13(COE)

Exemption be given from provisions of Minimum Audit Fees in case of public sector /other banks in charging fees for other similar assignments along with concurrent audit .

HM Update - 14 (COE)

Use of CA logo in the stamp is permissible subject to CA logo guidelines issued by the Institute.

HM Update - 15(COE)

A Chartered Accountant in practice may accept a professional assignment of investigation given by an Insurance Company.

HM Update - 16(COE)

An indebtedness of Rs. 10000/- or more would not impact a member's qualification as internal auditor of the company , as the Notification dated 2nd August, 2002 No. 1-CA(7)/63/2002 provides that for the purpose of indebtedness of a member to a concern , the term 'auditor' does not include internal auditor or a concurrent auditor.

HM Update - 17(COE)

In case of a CA firm providing Internal Audit and Tax Consultancy services to a holding company accepting appointment as the statutory auditor in the subsidiary company, there is possibility of independence of the auditor being compromised in the perception of ethics from the view point of the public. Hence the said assignment is not permissible.

HM Update -18(COE)

On the issue whether a member can be a Director in Cooperative Bank , it was decided that a member may be a Director Simplicitor in a Co-operative Bank , provided he is not in charge of the executive functions.

HM Update - 19(COE)

On the issue whether Paid Assistants in the CA firms be allowed to do attest functions, it was decided that attest functions are not permissible.



HM Update -20(COE)

Q. Can a concurrent auditor of a bank also undertake the assignment of quarterly review of the same bank?

A. No, the concurrent audit and the assignment of quarterly review of the same entity cannot be taken simultaneously as the concurrent audit is a kind of internal audit and the quarterly review is a kind of statutory audit.

HM Update -21(COE)

Whether a statutory auditor can accept the system audit of same entity?

Yes, the statutory auditor can accept the assignment of a system audit of the same entity, provided it did not involve any scrutiny/review of financial data and information.

HM Update-22(COE)

Whether a statutory auditor can be appointed in the adjourned meeting in place of existing statutory auditor where no special notice for removal or replacement of the retiring auditor is received at the time of the original meeting?

No, if any annual general meeting is adjourned without appointing an auditor, no special notice for removal or replacement of the retiring auditor received after the adjournment can be taken note of and acted upon by the company, since in terms of Section 190(1) of the Companies Act, 1956, special notice should be given to the Company at least fourteen clear days before the meeting

.HM- Update -23(COE)

Whether a Chartered Accountant who is appointed as tax auditor for conducting special audit under the Income-tax Act is required to communicate with statutory auditor?

Yes, Council directions under Clause (8) of Part I of First Schedule to the CA Act prescribe that it would be a healthy practice if a tax auditor appointed for conducting special audit under the Income-tax Act, communicates with the member who has conducted the statutory audit.

HM Update -24(COE)

LLP although body corporate to be construed as Firm for the purpose of Chartered Accountants Act and Regulations See Appendix (See appendix-1)



HM update -25(COE)

New guidelines have been issued to convert the existing firm into LLP (see appendix-2)

HM Update -26(Audit Under Companies Act)

Companies Act – Section 226(3) – the word firm included LLP for the limited purpose of that section (see appendix-3)

HM Update -27(AS-11)

AS-11, FCMITDA and Capitalisation of Forexdifferences deferment is again open from 1.4.2011 (see appendix -4)

HM Update -28(AS-11)

AS-11 the sunset clause of deferment which was expiring on 31.3.12 extended to 31.3.2020. (see appendix -5)

HM Update -29(Audit under Companies Act)

Amendment in Manner of reporting under section 227(3)(g). (see appendix -6)

HM Update -30(Audit Under Companies Act)

Amendment in manner of reporting under CARO about statutory dues.(see appendix -6)

HM Update -31(Standards on Assurance Engagement)

Introduction of SAE -3402 (see appendix -7)



Appendix-1

General Circular No. 10/2011

No. 17/71/2011-CL V
Government of India
Ministry of Corporate Affairs

5th Floor, A Wing, Shastri Bhavan,
Dr. R.P. Marg, New Delhi-110001
Dated : 04.04.2011

C I R C U L A R

Subject :- Interpretation of the word "Partnership" for the purpose of Chartered Accountants Act, 1949, Cost and Works Accountants Act, 1959 and Company Secretaries Act, 1980.

The Acts governing the three professional Institutes define in Section 2 members who are deemed to be in practice. In all the three Acts, there is a provision for a member to be in practice when he is in partnership with certain others. In the case of Chartered Accountants and Cost & Works Accountants, such persons must be member of the same Institute, while in the case of Company Secretaries, it is provided that the partnership could also be with members of such other recognised professions as may be prescribed.

2 At the time of enactment of the three Acts governing the professional Institutes, only one form of partnership existed in India, namely Partnerships under Indian Partnership Act, 1932. Subsequently, Parliament has enacted the Limited Liability Partnerships Act, 2008. Though Limited Liability Partnerships are bodies corporate under Section 3(i) of the LLP Act, the fact that LLPs are basically partnerships may be seen from the definition in Section 2(i) (n) :-

"Limited Liability Partnerships means a partnership formed and registered under this Act.

Section 2(i)(q) defines a partner as "any person who becomes a partner in the limited liability partnership in accordance with the Limited Liability Partnership Agreement"

It is thus clear that a Limited Liability Partnership is also a partnership and its members are also partners.

..2/-



3. The matter of permitting member of ICAI, ICWAI and ICSI was been examined in this Ministry. Acts governing these professionals were passed at a time when limited liability partnership did not exist. It is also clear from the definitions in the Limited Liability Partnership Act that such entities are also partnerships and their members are also partners. In the context of Section 2 of the Acts governing the professional Institutes, this interpretation is also not repugnant to the context. Accordingly, it is clarified that the words "partnership" wherever occurring in the Chartered Accountants Act, 1949, the Cost and Works Accountants Act, 1959 and the Company Secretaries Act, 1980 shall mutatis mutandis be construed as including those Limited Liability Partnerships where all the other partners are natural persons(individuals). The word "partner" shall also be construed accordingly. This clarification shall apply only to these three Acts and not to any other enactment where the word "partnership" occurs.
4. This issues with the approval of Competent Authority.

Yours faithfully,

(Seema Rath)
Assistant Director (Inspection)
Tele : 011-23387263

To
All Regional Directors
All Registrar of Companies
All Official Liquidators



Appendix-2

Appendix -2

COUNCIL GUIDELINES FOR CONVERSION OF CA FIRMS INTO LLPs

(Guidelines No.1-CA (7)/03/2011, dated 4th November, 2011)

In terms of the Council decision dated 14 July, 2011, following guidelines for conversion of CA firms into LLPs and constitution of separate LLPs by the practicing Chartered Accountants have been finalized which are applicable for conversion of CA firms into LLPs or formation of new LLPs by the members in practice of the Institute subject to the provisions of the Limited Liability Partnership (LLP) Act, 2008 and Rules & Regulations framed there under:-

(A) Conversion of CA firms into LLPs

1. All existing CA firms who want to convert themselves into LLPs are required to follow the provisions of Chapter-X of the Limited Liability Partnership Act, 2008 read with Second Schedule to the said Act containing provisions of conversion from existing firms into LLP.
2. In terms of Rule 18(2) (xvi) of LLP Rules- 2009, if the proposed name of LLP includes the words 'Chartered Accountant' or chartered Accountants, as the case may be, as part of the proposed name, the same shall be referred to the Institute of Chartered Accountants of India (ICAI) by the Registrar of LLP and it shall be allowed by the Registrar only if the Secretary, ICAI approves it.
3. If the proposed name of LLP of CA firm resemble with any other non-CA entity as per the naming Guidelines under LLP Act and its Rules, the proposed name of LLP of CA firms may include the word 'Chartered Accountant' or 'Chartered Accountants', as the case may be in the name of the LLP itself and the Registrar, LLP may allow the same name, subject to compliance to Rule 18(2) (xvi) of LLP Rules as referred above.
4. For the purpose of registration of LLP with ICAI under regulation 190 of the Chartered Accountants Regulations, 1988, the partners of the firm shall apply in ICAI Form No. '117' and the ICAI Form No. '18' along with copy of name registration received from the Registrar of LLP and submit the same with the concerned Regional office of the ICAI. These Forms shall contain all details of the officers and other particulars as called for together with the signatures of all partners or authorized partner of the proposed LLP.
5. The names of the CA firms registered with the ICAI shall remain reserved for the partners as one of the options for LLP names subject to the provisions of LLP Act, Rules and Regulations framed there under.
6. The following guidelines relating to seniority and other criteria shall be followed for registration of LLP with ICAI.
 - (i) Where two similar or identical or nearly similar firm names (whether the partners of such firms are same or not) have been registered by ICAI, under the purposed LLP, only one such firm name shall be



approved and remaining firm registered with ICAI, either desires to convert into LLP or not, a change in the firm name shall be required.

(ii) The name of the LLP may be like 'X & Co. LLP' or 'X & Associates LLP' and no other suffix shall be approved and registered by ICAI.

(iii) The newly converted CA LLPs registered with ICAI shall be allowed to work only in terms of Section 2(2) of the Chartered Accountants Act, 1949 and the object of LLP to be incorporated in Form-2 and Form 17 of the LLP rules, 2009 or in LLP agreement, shall be in the nature of Professional Services allowed under Section 2(2) of the Chartered Accountants Act, 1949. LLP shall be subject to the same regulations, as if they were in partnership firm. Mere conversion into LLP does not give any privileges, which were not earlier with the CA firms.

(iv) Inter-se seniority among the firms shall be given to LLP as per existing policy of ICAI. In other words, LLPs shall carry the same seniority, as the firm shall otherwise have under the existing policy of ICAI. In case of merger of 2 LLPs, same rules as applicable to firms merging shall apply.

(v) The non converted firms shall also remain on the same position of seniority in relation to converted LLPs as the converted LLPs shall have the same inter-se seniority as the firms had earlier to conversion. 7. These guidelines of conversion of CA firms into LLP shall also be applicable to the conversion of proprietary firm into LLP subject to the provisions of LLP Act, Rules and Regulations framed there under. The conversion of proprietary firm shall be by way of incorporation of new LLPs.

8. The registration number (with minimum 6 numbers) of LLP with ICAI, shall remain the same Firm Registration Number (FRN) allotted to the firm before the conversion by ICAI

9. Introduction of LLP, shall not affect the existing regulations in force as regards the name allotment to chartered accountants firms.

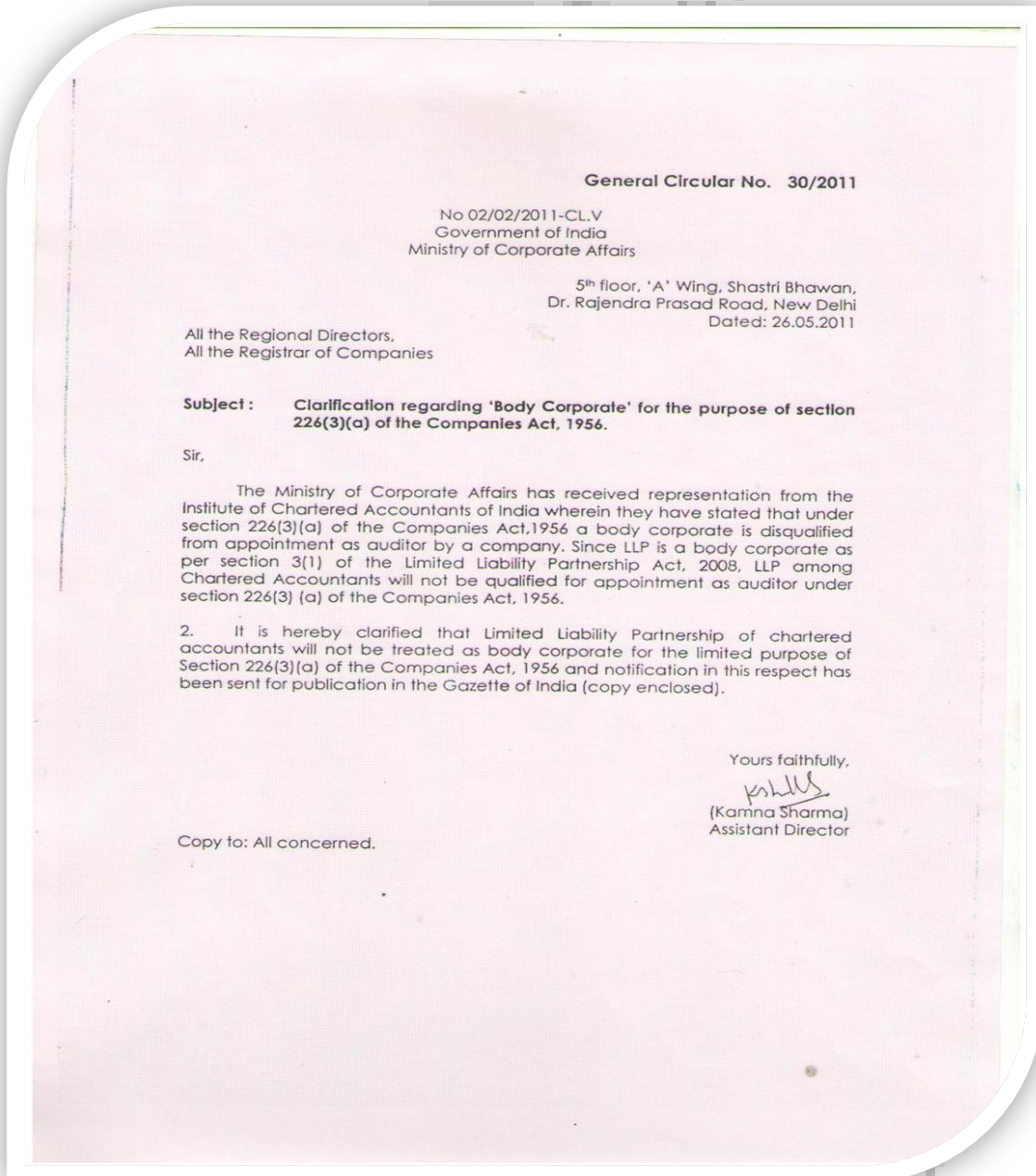
10. In case there is a merger of a firm and conversion with LLP and vice-versa, seniority may be provided to the surviving entity as per policy as per Annexure 'A' attached herewith.

11. The provisions of CA Act, 1949, Chartered Accountants Regulations, 1988 and Code of Ethics issued by ICAI shall be applicable to all partners of the converted CA firms into LLP jointly and severally.

More guidelines have been prepared but they are subject to governments approval hence not reproduced here.



Appendix -3



Appendix-4

[TO BE PUBLISHED IN THE GAZETTE OF INDIA, EXTRAORDINARY PART II,
SECTION 3, SUB-SECTION (i)]

GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS
NOTIFICATION

New Delhi, dated 29 December, 2011

GSR :- In exercise of the Powers conferred by clause (a) of sub-section (1) of section 642 read with sub-section (1) of section 210A and sub-section (3C) of section 211 of the Companies Act, 1956 (1 of 1956), the Central Government in consultation with the National Advisory Committee on Accounting Standards, hereby makes the following amendments in the Companies (Accounting Standards) Rules, 2006, namely :-

1. (1) These rules may be called the Companies (Accounting Standards) (Second Amendment) Rules, 2011.
(2) They shall come into force on the date of their publication the Official Gazette.
2. In the Companies (Accounting Standards) Rules, 2006, (hereinafter referred to as the said rules), in the Annexure, Under the heading "B. ACCOUNTING STANDARDS", in the sub-heading "Accounting Standard (AS) 11" relating to "The Effects of Changes in Foreign Exchange Rates", after paragraph 46, the following paragraph shall be inserted, namely,-
" 46A. (1) In respect of accounting periods commencing on or after the 1st April, 2011, for an enterprise which had earlier exercised the option under paragraph 46 and at the option of any other enterprise (such option to be irrevocable and to be applied to all such foreign currency monetary items), the exchange differences arising on reporting of long-term foreign currency monetary items at rates different from those at which they were



initially recorded during the period, or reported in previous financial statements, in so far as they relate to the acquisition of a depreciable capital asset, can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, and in other cases, can be accumulated in a "Foreign Currency Monetary Item Translation Difference Account" in the enterprise's financial statements and amortized over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods, with the exception of exchange differences dealt with in accordance with the provisions of paragraph 15 of the said rules.

- (2) To exercise the option referred to in sub-paragraph (1), an asset or liability shall be designated as a long term foreign currency monetary item, if the asset or liability is expressed in a foreign currency and has a term of twelve months or more at the date of origination of the asset or the liability:

Provided that the option exercised by the enterprise shall disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every subsequent period so long as any exchange difference remains unamortized."

[F.No.17/133/2008-CL.V]



RENUKA KUMAR

Joint Secretary to the Government of India

Foot Note: The Principal regulations were published in the Gazette of India, Extraordinary, Part II, Section 3, sub-section (i) vide GSR 739(E), dated the 7th December, 2006 and amended vide notification number G.S.R.212(E), dated the 27th March, 2008 and subsequently amended by GSR No. 225(E), dated the 31st March, 2009 and GSR No. 378(E), dated the 11th May, 2011.



Appendix - 5

TO BE PUBLISHED IN THE GAZETTE OF INDIA,
EXTRAORDINARY PART II, SECTION 3, SUB-SECTION (i)]

GOVERNMENT OF INDIA
MINISTRY OF CORPORATE AFFAIRS

Notification

New Delhi dated 29/12/2011

GSR. :- In exercise of the powers conferred by clause (a) of sub-section (1) of Section 642 read with sub-section (1) of Section 210A and sub-section (3C) of Section 211 of the Companies Act, 1956 (1 of 1956), the Central Government in consultation with the National Advisory Committee on Accounting Standards, hereby makes the following amendment in the Companies (Accounting Standards) Rules, 2006, hereinafter called the said rules, namely:-

1. (1) These rules may be called the Companies (Accounting Standards) Amendment Rules, 2011.

(2) They shall come into force on the date of their publication in the Official Gazette.
2. In the said rules, in the annexure under the heading "B. Accounting Standard", in the sub-heading "Accounting Standard (AS) 11" relating to "The Effects of Changes in Foreign Exchange Rates", in paragraph 46, for the words and figures "46. In respect of accounting periods commencing on or after 7th December, 2006 and ending on or before 31st March, 2012", the following shall be substituted, namely :-



"46. In respect of accounting periods commencing on or after 7th December, 2006 and ending on or before 31st March, 2020.

{F.No. 17/133/2008-CL.V}


RENUKA KUMAR

Joint Secretary to the Govt. of India

Foot Note: The Principal regulations were published in the Gazette of India, Extraordinary, Part II, Section 3, sub-section (i) vide GSR 739(E), dated the 7th December, 2006 and amended vide notification number G.S.R.212(E), dated the 27th March, 2008 and subsequently amended by GSR No. 225(E), dated the 31st March, 2009 and GSR No. 378(E), dated the 11th May, 2011.



Appendix -6

ANNOUNCEMENT**Statutory Auditor's Reporting Responsibilities in Respect of Depositing of Cess Pursuant to Clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and Section 227(3)(g) of the Companies Act, 1956**

1. The Council of the Institute, at its 312th meeting held on December 25 - 27, 2011, noted that paragraph 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 required the statutory auditor to report on the matter relating to regularity of the company in depositing undisputed statutory dues as follows:

"Is the company regular in depositing undisputed statutory dues including Provident Fund, Investor Education and Protection Fund, Employees' State Insurance, Income-tax, Sales-tax, Wealth Tax, Service Tax, Custom Duty, Excise Duty, Cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.[Paragraph 4(ix)(a)]"

2. The Council also noted that paragraph 63(g) of the Statement on the Companies (Auditor's Report) Order, 2003, issued by the Institute of Chartered Accountants of India states as follows:

It may be noted that at present, no Rules relating to the amount of cess for rehabilitation or revival or protection of assets of sick industrial companies, payable by a company under section 441A of the Act have been notified by the Central Government. Thus, it would not be possible for the auditor to comment on the regularity or otherwise about the cess till the time relevant rules or regulations are issued. However, till the time such Rules are prescribed, the auditor should also state in his report under this clause that the Government has not notified any Rules under section 441A of the Companies Act, 1956 and, therefore, the auditor is unable to comment on this particular issue. (emphasis added)

3. The Council noted that till date the Central Government had not notified the effective date of section 441A of the Companies Act, 1956. Consequently, no Rules thereunder had also been prescribed by the Central Government. Accordingly, there was no question of reporting thereon



under the Companies (Auditor's Report) Order, 2003. The Council, therefore, decided that in view of the aforementioned situation, the statutory auditor need not report in respect of cess payable under section 441A of the Companies Act, 1956 as envisaged under paragraph 63(g) of the Statement on the Companies (Auditor's Report) Order, 2003. The Council, therefore, decided to modify paragraph 63(g) of the said Statement as follows:

"It may be noted that at present, no Rules relating to the amount of cess for rehabilitation or revival or protection of assets of sick industrial companies, payable by a company under section 441A of the Act have been notified by the Central Government. Thus, it would not be possible for the auditor to comment on the regularity or otherwise about the cess till the time relevant rules or regulations are issued. ~~However, till the time such Rules are prescribed, the auditor should also state in his report under this clause that the Government has not notified any Rules under section 441A of the Companies Act, 1956 and, therefore, the auditor is unable to comment on this particular issue. However, till the time such Rules are prescribed, the auditor need not make any comment in respect of the Cess under section 441A of the Companies Act, 1956 in his report under paragraph 4(ix)(a) of CARO 2003.~~"

4. The Council, incidentally, also noted that section 227(3)(g) of the Companies Act, 1956 required the statutory auditor's report to state, "Whether the cess payable under section 441A has been paid and if not, the details of amount of cess not so paid." It was also noted that the operative date of even section 227(3)(g) had not yet been notified by the Central Government.
5. Accordingly, as a corollary to the Council's views on auditor's reporting responsibilities on cess under section 441A of the Companies Act, 1956, pursuant to clause 4(ix)(a) of CARO, 2003, the Council was of the view that the statutory auditor's report need not contain any comment on section 227(3)(g) of the Companies Act, 1956.



Appendix-7

Standard on Assurance Engagements (SAE) 3402 Assurance Reports on Controls At a Service Organization

Introduction

Why this SAE?

This Standard on Assurance Engagements (SAE) deals with assurance engagements undertaken by a professional accountant in public practice² to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities' internal control as it relates to financial reporting. It complements SA 402,³ in that reports prepared in accordance with this SAE are capable of providing appropriate evidence under SA 402.

What are objectives of an auditor explained in this SAE?

The objectives of the service auditor are:

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

How to achieve the abovementioned objectives?

A. Obtaining Evidence Regarding the Description

The service auditor shall obtain and read the service organization's description of its system, and shall evaluate whether those aspects of the description included in the scope of the engagement are fairly presented, including whether:

- (a) Control objectives stated in the service organization's description of its system are reasonable in the circumstances;)
- (b) Controls identified in that description 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.

The service auditor shall determine, through other procedures in combination with inquiries, whether the service organization's system has been implemented. Those 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.

B. Obtaining Evidence Regarding Design of Controls

The service auditor shall determine which of the controls at the service organization are necessary to achieve the



control objectives stated in the service organization's description of its system, and shall assess whether those controls were suitably designed. This determination shall include:

- (a) Identifying the risks that threaten the achievement of the control objectives stated in the service organization's description of its system; and
- (b) Evaluating the linkage of controls identified in the service organization's description of its system with those risks.

C. Obtaining Evidence Regarding Operating Effectiveness of Controls

When providing a type 2 report, the service auditor shall test those controls that the service auditor has determined are necessary to achieve the control objectives stated in the service organization's description of its system, and 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.

When designing and performing tests of controls, the service auditor shall:

- (a) Perform other procedures in combination with inquiry to obtain evidence about:
 - (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 controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain evidence supporting the operating effectiveness of those indirect controls; and
- (c) Determine means of selecting items for testing that are effective in meeting the objectives of the procedure.

When determining the extent of tests of controls, the service auditor shall consider matters including the characteristics of the population to be tested, which includes the nature of controls, the frequency of their application (for example, monthly, daily, a number of times per day), and the expected rate of deviation.

D. The Work of an Internal Audit Function

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.

E. Determining Whether and to What Extent to Use the Work of the Internal Auditors

The service auditor shall determine:

- (a) Whether the work of the internal auditors is likely to be adequate for purposes of the engagement; and
- (b) If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures.

F. Modified Opinions

If the service auditor concludes that:

- (a) The service organization's description does not fairly present, in all material respects, the system as designed and implemented;
- (b) The controls related to the control objectives stated in the description were not suitably designed, in all material respects;
- (c) In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or
- (d) The service auditor is unable to obtain sufficient appropriate evidence, the service auditor's opinion shall be modified, and the service auditor's assurance report shall contain a clear description of all the reasons for the modification.



