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Dear Mr Sylph

Proposed International Standard on Auditing 402, Audit Considerations Relating to an Entity Using a Third Party Service Organisation (ISA 402)

The Committee of European Banking Supervisors welcomes the opportunity to comment on the proposed International Standard on Auditing 402, Audit Considerations Relating to an Entity Using a Third Party Service Organisation (ISA 402)

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model and contribute to the financial stability of the market. As banking supervisors we therefore have an interest in ensuring that auditing standards, which are the basis for audit work, are of a high quality and are clear and capable of consistent application.

We appreciate the efforts of the International Auditing and Assurance Standards Board (IAASB) to revise and clarify the auditing standard.

We have some concerns about the objective for the ISA; the structure of the ISA and the language used in some of the application material.

We provide more detail on these points, and other comments in response to the questions posed by the IAASB, in the attached appendix.

Our comments were coordinated by our Expert Group on Financial Information (EGFI), and especially by its Subgroup on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGFI, Arnoud Vossen (+44.20.7382.1792) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely



Kerstin af Jochnick
Chair

Appendix

Comments on ISA 402, Audit Considerations Relating to an Entity Using a Third Party Service Organisation (ISA 402)

Question 1: Is the ISA capable of being adapted to situations where an entity uses a shared service centre which provides services to a group of related entities?

We are aware of the growth in the use of shared service centres in large groups e.g. some of the larger financial institutions which we supervise. Therefore we would welcome the use of this ISA to assist in audits where there are shared service centres. We would urge the IAASB to reflect on whether there is a need for any specific additional requirements in this area and associated application material. Issues to be addressed might include:

- Identifying where audit work carried out on one group member might be used as assurance across the whole group; and
- The need to consider inter group entity control mechanisms

Question 2: Is the objective appropriate and are the proposed requirements appropriate responses to the objective?

We do not believe that the objective as currently drafted is appropriate. The objective emphasises that the auditor has to obtain an understanding of how the user entity uses a service organization. It does not seem to emphasise enough that the auditor has to obtain sufficient appropriate audit evidence to ensure they have responded appropriately to the risks of material misstatement arising from the user entity's use of service organizations.

We believe there could be some revisions to the proposed requirements in terms of the flow of the requirements and the content of some of the requirements as follows:

Flow of the requirements

Our impression from ISA 402 is that there is an undue emphasis on how the auditor should use an assurance report from a service auditor. However, this is not likely to be the case in the wide variety of audit engagements, and we believe there needs to be more obvious emphasis in ISA 402 on how the auditor should assess and respond to the risks of material misstatement. This would be assisted if the flow of the requirements more closely followed ISA 315 and ISA 330.

This could be undertaken by:

- Linking paragraph 12 more closely to paragraph 23 of ISA 330 and rewording the heading to reflect that this is also about responding to the risks of material misstatement;
- Possibly moving paragraph 12 to link in better with paragraph 18 and to follow the paragraphs about use of the service auditor's report;
- Repositioning paragraph 15 so that it is part of paragraph 13; and
- Moving paragraphs 16 and 17 which deal with auditor reporting and use of the service auditor's report to a separate section on reporting at the end of the requirements section.

Content of the requirements

Paragraph A31 states: "The fact that a user entity uses a service organization does not alter the user auditor's responsibility under ISAs to obtain sufficient appropriate audit evidence to afford a reasonable basis to support the user auditor's opinion" We believe that this statement is key to understanding the standard and therefore would suggest moving it to the beginning of paragraph 9.

We would also suggest the following amendments to clarify paragraph 11.

It does not seem to be sufficiently clear that the auditor would be obtaining an understanding which covers more than the role of internal controls. We suggest redrafting as per the bold text below.

"...a sufficient understanding of the nature and significance of the **services provided by the service organization and their effect on the** user entity's internal control relevant to the audit...".

We would also suggest amending paragraph 11 (b) to read "Contacting the service organization, **with the permission of** the user entity, to obtain specific information;" in order to give more emphasis to the idea that the auditor should have a direct relationship with the service organization. We believe that this is important with respect to the auditor's objective to obtain audit evidence in order to identify and assess risks of material misstatement.

We also would propose including in the beginning of section "Using an assurance report from a service auditor" a new requirement setting out that the user auditor's use of the work of a service auditor shall not diminish the user auditor's responsibility for the audit opinion. While this idea is already to some extent addressed in paragraphs 16 and 17 they only refer to the specific situation where there is an explicit reference in the auditor's report to the work of a service auditor. We would prefer that the standard contains a general requirement in this respect.

A16 states that 'If the user auditor is unable to obtain an understanding of the user entity's internal control relevant to the audit by performing the procedures required by paragraphs 9-11 of this ISA, the auditor is required to modify the opinion in the auditor's report. This is a requirement, albeit conditional, which we assume would only apply when the matter is of material significance, and therefore be included in the requirements section.

Application Material

We note that A 33 covers the key types of audit procedure which an auditor would use in responding to the risks of material misstatement e.g. inspecting records; obtaining confirmations etc. However we note that the stem of A 33 states that the 'following procedures **may be considered** by the user auditor..' (our bold text). We would be concerned if this language implied that all of the procedures listed were optional. We would suggest that the stem of A33 could be reworded as follows:

'In determining the nature and extent of audit evidence..... the auditor considers the following procedures...'

Appendix

We note that the appendix includes some terms that may not translate well outside a common law context e.g. 'investment companies'. We would suggest it would be useful to review the appendix to ensure any terms used, as far as possible, are relevant and understandable, across jurisdictions.