

**STATEMENT OF AUDITING STANDARDS
480
AUDIT CONSIDERATIONS RELATING TO
ENTITIES USING SERVICE ORGANIZATIONS**

*(Effective for audits of financial statements for periods beginning before 15 December 2004)**

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* HKSA 402 “Audit Considerations Relating to Entities Using Service Organizations” is effective for audits of financial statements for periods beginning on or after 15 December 2004.

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*Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

Introduction

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance to auditors whose client uses a service organization. This SAS also describes service organization auditors' report which may be obtained by client auditors.
2. For the purposes of this SAS:
 - a. "client" means the entity that uses the services of the service organization;
 - b. "client auditors" means the auditors engaged to report on the financial statements of the client;
 - c. "service organization" means an entity that provides services to the client to record, process, execute transactions, maintain related accountability for these transactions, or any combination thereof. Examples of service organizations include:
 - i. a computer service bureau that provides data processing functions for other entities;
 - ii. an investment custodian that provides investment custodian services as described in Practice Note 860.2 "Reports on internal controls of investment custodians made available to third parties";
 - d. "service organization auditors" means the auditors who are engaged to perform an audit on, or a related service on, or provide a written description about aspects of the service organization.
3. ***The client auditors should consider how a service organization affects the client's accounting and internal control systems so as to plan the audit and develop an effective audit approach. (SAS 480.1)***
4. If the client uses a service organization, certain policies, procedures and records maintained by the service organization may be relevant to the audit of the financial statements of the client.

Considerations of the client auditors

5. A service organization may establish and execute policies and procedures that affect the client's accounting and internal control systems. These policies and procedures are physically and operationally separate from the client. When the services provided by the service organization are limited to recording and processing client's transactions and the client retains authorization and maintenance of accountability, the client may be able to implement effective policies and procedures within its organization. When the service organization executes the client's transactions and maintains accountability, the client may deem it necessary to rely on policies and procedures at the service organization.
6. ***The client auditors should determine the significance of service organization activities to the client and the relevance to the audit. (SAS 480.2)***
7. In doing so, the client auditors would need to consider the following, as appropriate:
 - a. Nature of the services provided by the service organization.

- b. Terms of contract and relationship between the client and the service organization.
 - c. The material financial statement assertions that are affected by the use of the service organization.
 - d. Inherent risk associated with those assertions.
 - e. Extent to which the client's accounting and internal control systems interact with the systems at the service organization.
 - f. The client's internal controls that are applied to the transactions processed by the service organization.
 - g. Service organization's capability and financial strength, including the possible effect of the failure of the service organization on the client.
 - h. Information about the service organization such as that reflected in customer and technical manuals.
 - i. Information available on general controls and computer systems controls relevant to the client's applications.
8. Consideration of the above may lead the client auditors to decide that the control risk assessment will not be affected by controls at the service organization; if so, further consideration of this SAS is unnecessary.
 9. The client auditors would also consider the existence of third-party reports from service organization auditors or internal auditors as a means of providing information about the accounting and internal control systems of the service organization and about its operation and effectiveness.
 10. ***If the client auditors conclude that the activities of the service organization are significant to the client and relevant to the audit, they should obtain sufficient information to understand the accounting and internal control systems at the client, and where appropriate the services organization, and to assess control risk at either the maximum, or a lower level if tests of control are performed. (SAS 480.3)***
 11. If information is insufficient, the client auditors would consider the need to request the service organization to have the service organization auditors perform such procedures as to supply the necessary information, or the need to visit the service organization to obtain the information. The client auditors wishing to visit a service organization may advise the client to request the service organization to give the client auditors access to the necessary information.
 12. The client auditors may be able to obtain an understanding of the accounting and internal control systems affected by the service organization by reading the third-party report of the service organization auditors. In addition, when assessing control risk for assertions affected by the systems' controls of the service organization, the client auditors may also use the third-party report of the service organization auditors.
 13. ***If the client auditors use the third-party report of the service organization auditors, the client auditors should consider making enquiries concerning the service organization auditors' professional competence in the context of the specific assignment undertaken by the service organization auditors. (SAS 480.4)***
 14. The client auditors may conclude that it would be efficient to obtain audit evidence from tests of control to support an assessment of control risk at a lower level. Such evidence may be obtained by:
 - a. performing tests of the client's controls over activities of the service organization;
 - b. obtaining a third-party report of the service organization auditors that expresses an assurance as to the operating effectiveness of the service organization's accounting and internal control systems for the processing applications relevant to the audit; and
 - c. visiting the service organization and performing tests of control.

Third-party reports of the service organization auditors

15. *When using a third-party report of the service organization auditors, the client auditors should consider the nature of and content of that report. (SAS 480.5)*

16. The third-party report of the service organization auditors will ordinarily be one of two types as follows:

Type A-Report on suitability of design

- a. a description of the service organization's accounting and internal control systems, ordinarily prepared by the management of the service organization; and
- b. an assurance by the service organization auditors that:
 - i. the above description is accurate;
 - ii. the systems' controls have been placed in operation; and
 - iii. the accounting and internal control systems are suitably designed to achieve their stated objectives.

Type B-Report on suitability of design and operating effectiveness

- a. a description of the service organization's accounting and internal control systems, ordinarily prepared by the management of the service organization; and
- b. an assurance by the service organization auditors that:
 - i. the above description is accurate;
 - ii. the systems' controls have been placed in operation;
 - iii. the accounting and internal control systems are suitably designed to achieve their stated objectives; and
 - iv. the accounting and internal control systems are operating effectively based on the results from the tests of control. In addition to the opinion on operating effectiveness, the service organization auditors would identify the tests of control performed and related results.

17. The third-party reports of the service organization auditors will ordinarily contain restrictions as to use (generally to management, the service organization and its customers, and the client auditors).

18. *The client auditors should consider the scope of work performed by the service organization auditors and should assess the usefulness and appropriateness of the third-party reports of the service organization auditors. (SAS 480.6)*

19. While Type A reports may be useful to client auditors in gaining the required understanding of the accounting and internal control systems, client auditors would not use such reports as a basis for reducing the assessment of control risk.

20. In contrast, Type B reports may provide such a basis since tests of control have been performed. When a Type B report is to be used as evidence to support a lower control risk assessment, the client auditors would consider whether the controls tested by the service organization auditors are relevant to the client's transactions (significant assertions in the client's financial statements) and whether the service organization auditors' tests of control and the results are adequate. With respect to the latter, two key considerations are the length of the period covered by the service organization auditors' tests and the time since the performance of those tests.

21. *For those specific tests of control and results that are relevant, the client auditors should consider whether the nature, timing and extent of such tests provide sufficient appropriate audit evidence about the effectiveness of the accounting and internal control systems to support the client auditors' assessed level of control risk. (SAS 480.7)*

22. The service organization auditors may be engaged to perform substantive procedures that are of use to the client auditors. Such engagements may involve the performance of procedures agreed upon by the client and the client auditors and by the service organization and the service organization auditors.
23. *When the client auditors use a third-party report of the service organization auditors, no reference should be made to this third-party report in the client auditors' report. (SAS 480.8)*

Compliance with International Standards on Auditing

24. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 402 "Audit Considerations Relating to Entities using Service Organizations".

Effective date

25. This SAS is effective for audits of financial statements for periods beginning before 15 December 2004. |