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IAASB exposure draft ISA 402 (revised and redrafted), audit considerations relating to an entity using a third party service organisation

Dear Mr Sylph

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on your recent exposure draft. The Committee has a strong interest in high quality and independent audits of banks and has carefully analysed the proposal captioned above.

We appreciate the efforts of the International Auditing and Assurance Standards Board (IAASB) to revise and redraft this ISA. However, we have concerns about the following in relation to the ISA:

- the appropriateness of the objective;
- the structure and linkage of the requirements in the proposed ISA with other ISAs (eg ISA 315 (redrafted)), Identifying and assessing the risks of material misstatements through understanding the entity and its environment, and ISA 330 (redrafted), The auditor’s responses to assessed risks; and
- some of the application material.

We have provided more detailed comments in the attached appendix. These comments have been prepared by the Committee’s Accounting Task Force, chaired by Ms Sylvie Mathérat, Director of the Bank of France, and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive.
If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat (+33 1 4292 6579), Marc Pickeur, who chairs the Audit Subgroup of the Accounting Task Force (+32 2 220 5253), or Linda Ditchkus at the Basel Committee Secretariat (+41 61 280 8007).

Yours sincerely,

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The Basel Committee on Banking Supervision\(^1\) (the Committee) has a strong interest in high quality and independent audits of banks and has carefully analysed the proposed revised and redrafted International Standard on Auditing (ISA) pertaining to the audit considerations relating to an entity using a third party service organisation. The remainder of this appendix highlights certain issues, questions and suggestions for the Board’s consideration.

Request for specific comments, 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?

It is common for large groups to make use of shared service centres (eg some of the larger financial institutions which we supervise). We therefore would support the development 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 related to the use of a shared service centre that has been carried out on one group member might be used as assurance across the whole group; and
- The need to consider intragroup entity control mechanisms.

Comments related to the objective and proposed requirements:

We do not believe that the objective as currently drafted is appropriate. The current objective emphasises that the auditor has to obtain an understanding of how the user entity uses a service organisation. It does not seem to adequately emphasise that the auditor has to obtain sufficient appropriate audit evidence to ensure that he or she has responded appropriately to

\(^1\) The Basel Committee on Banking Supervision is a committee of banking supervisory authorities, which was established by the central bank Governors of the Group of Ten countries in 1975. It consists of senior representatives of bank supervisory authorities and central banks from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. It usually meets at the Bank for International Settlements in Basel, where its permanent Secretariat is located.
the risks of material misstatement in the user entity's financial statements arising from its use of service organisations.

Structure and linkage of the requirements with ISA 315 and ISA 330

We believe that the proposed ISA 402 unduly emphasises audit procedures concerning how the auditor should use an assurance report from a service auditor. We believe there should be more emphasis in ISA 402 on how the auditor should assess and respond to the risks of material misstatement where no service auditor's assurance report is available for a service organisation used by a user entity. This would be assisted if the flow of the requirements more closely followed ISA 315 (revised), *Identifying and assessing the risks of material misstatements through understanding the entity and its environment*, and ISA 330 (revised), *The auditor's responses to assessed risks*.

Content of the requirements

We would suggest the following revision to paragraph 11 to clarify that the auditor would be obtaining an understanding of more than the role of internal control. We suggest redrafting this paragraph as per the bold text below.

“...a sufficient understanding of the nature and significance of the services provided by the service organisation and their effect on the user entities’ internal control relevant to the audit...”

Paragraph 15 states that “the user auditor shall be satisfied as to the service auditor's professional reputation, competence and independence”. We believe that this requirement should be strengthened and rewritten in a more active form rather than as the passive “be satisfied”. We recommend revising this paragraph to read “the user auditor shall assess and be satisfied as to the service auditor's professional reputation, competence and independence.”

Paragraphs A16 and A31 include material that would seem to specify actions (eg modification of the audit opinion) that “would be expected to be appropriate in virtually all such circumstances.” Therefore we suggest that the actions in these paragraphs be elevated to requirements.

Other comments:

Definition of a service organisation

Various firms provide pricing services (eg quotes and other pricing information used to support fair value measurements) to the institutions that we supervise. We are unclear whether a pricing service is a third party service organisation that would fall within the scope of proposed ISA 402 or whether it would be a “management’s expert”, which is addressed in proposed ISA 620, *Using the Work of an Auditor's Expert*.

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2 IAASB criteria for determining the requirements of a Standard, as explained in footnote 3 in the explanatory memorandum.
One could argue that a pricing service falls within the definition of a “service organisation” in proposed ISA 402 because a pricing service “provides services to user entities that are part of those entities’ information system relevant to financial reporting” because these services affect several of the items listed in paragraph 3 of the proposed ISA 402. On the other hand, proposed ISA 620 defines an “expert” as “a person or organisation, possessing expertise in a field other than accounting or auditing”. Paragraph A30(a) of the conforming amendments to ISA 500, *Considering the Relevance and Reliability of Audit Evidence*, states that “the preparation of an entity’s financial statements may require expertise in a field other than accounting, such as actuarial calculations, valuations, or engineering data”, and the conforming amendment to paragraph 3 of ISA 500 is the addition of a sentence that states that “information that may be used as audit evidence may have been prepared by an expert employed or engaged by the entity”.

We believe it would be helpful for consistency of audit practice in this area if this point were clarified.

**Application Material**

Paragraph A33 covers the key types of audit procedures that an auditor would use in responding to the risks of material misstatement (eg inspecting records and obtaining confirmations). However we note that the introduction in paragraph A33 states that the “following procedures may be considered by the user auditor” (emphasis added). We are concerned that this language implies that all of the procedures listed in paragraph A33 are optional. We suggest that the introduction in paragraph A33 be reworded as follows:

“In determining the nature and extent of audit evidence … by a service organisation, the user auditor considers the following procedures…”

**Appendix**

We note that the appendix includes some terms that may not translate well outside of common-law system contexts (eg “investment companies” and “trust department”). We would suggest it would be useful to review the appendix to ensure that any terms used, as far as possible, are more generic and capable of application across jurisdictions.

We also note that the wording of “Mortgage servicers or depository institutions that service loans for others” in the appendix could be improved. The description of this example in the appendix focuses exclusively on mortgages even though the caption refers to “loans” more generally. We suggest that the description should make clear that a servicer could be servicing other types of loans, including participation interests in other types of loans, for a user entity.