Farewell to SAS 70

What you need to know about the New Standard for Service Organization Reporting

ADVISORY

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Agenda

- SAS 70 (Service Reporting) Basics
- Brief History vs. Today
- New Standard Core Concepts
- New Terms to Learn
- Key Elements and Discussion Points
- What Should Service Organizations Do?
- Q&A/Frequent Questions

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SAS 70 (Service Reporting) Basics

- Evaluation of the design and operating effectiveness of controls to achieve specific control objectives (but not a certification).
- Report includes detailed information about the processes, controls, tests performed, and results of the tests.
- Report also includes an opinion about whether each control objective was achieved.
- Must be performed by a CPA.
- Report is used by management, customers, and the auditors of customers.
- SAS 70 is the generally accepted report used by customers and their auditors that complies with PCAOB requirements.
- Incorporated as a requirement in many contracts between service organizations and their customers.

All of these bullets remain true given the changes in the new standards!

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Brief History vs. Today

- Service organization audit standards have evolved over 40+ years.
- In the post-SOX era, SAS 70 became a de facto global standard.
- The IAASB included service auditor reporting on its agenda over two years ago, resulting in the development of an international (IFAC) standard:
  - The current SAS 70 standard will be retired.
  - The old standard will be bifurcated into two new standards: one that applies to user auditors; and one that applies to the service auditor.
- U.S. Auditing Standards Board agreed to conform to IAASB approach.
- IAASB has approved the international version of the new standards and the ASB issued the U.S. version of the standards in March, 2010.
- New standard is effective for reports covering periods ending on or after June 15, 2011.

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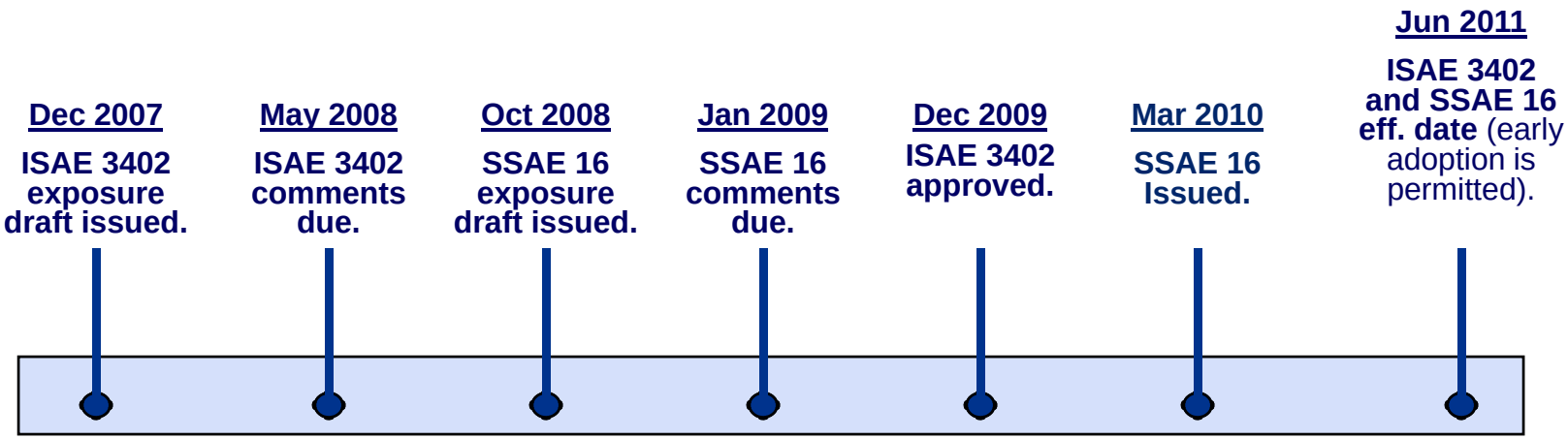
Background

- The **ASB** in the United States has issued Statement on Standards for Attestation Engagement #16 (SSAE 16), which is based on the International Standard on Assurance Engagement 3402 (ISAE 3402) published by the **IAASB**.
- In addition, **ASB** has approved a new auditing standard for user auditors.



History of standards development

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Replacement, but Not a Rewrite

- The intent of service auditor reporting is not changing much
- Report will still serve the same basic purpose: auditor-to-auditor communication
- Underlying work effort for the service auditor will likely be ~95% the same for most engagements
- Will report on the same three elements based on the control objectives
  - Fairness of Presentation
  - Suitability of Design
  - Effectiveness of Operation
- Will still be restricted to current users of the system and their auditors

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New Standard Core Concepts

Similarities and differences between SAS 70 and the new standards

Similarities	Differences
▪ Underlying work effort expected to be substantially the same ▪ Two types of reports (Type I and Type II) ▪ Type II reports should cover a minimum of six months ▪ Restriction on use – remains the same ▪ Service auditor's tests included in report ▪ Sample sizes disclosed only when exceptions are identified	▪ The new standard is part of the attestation standards (SSAE) - No longer a "SAS 70" report ▪ Management will be required to provide **an assertion**, which will be included in the report ▪ In a Type II report, all three assertions/opinions will be **for a period of time**. (In a SAS 70 Type II report, the opinions on "fairness of presentation" and "suitability of design" are only as of the date at the end of the period)

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New Terms to Learn

- "User Entity" (Formerly user organizations)
- "Complementary User Entity Controls" (Formerly client control considerations)
- "Service Organization's System" – definition:
  - The policies and procedures designed, implemented, and maintained by the service organization to provide user entities with the services covered by the service auditor's report including items such as:
    - The description of the service organization's system
    - The services covered
    - The period to which the description relates
    - The control objectives and the related controls.
- "Criteria":
  - Standards to evaluate the subject matter of the report
  - A defined term under AT101

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New Terms to Learn (continued)

- Attestation Standards:
  - "An examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter, that is the responsibility of another party."
- Other Types of Attest Reports:
  - SysTrust ® and WebTrust ®:
    - AICPA defined attestation over the Security, Availability, Processing Integrity, Confidentiality, and/or Privacy of a system
  - Agreed-upon Procedures:
    - Report of findings based on specific procedures performed on subject matter
  - Compliance Attestation:
    - Engagements related to either (a) an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants or (b) the effectiveness of an entity's internal control over compliance with specified requirements

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Fundamentals of Change

- The SAS 70 is being be split into two new standards:
  - **Reporting on Controls at Service Organizations** – Statement on Standards for Attestation Engagement 16 (SSAE 16)
  - **Audit Considerations Relating to an Entity Using a Service Organization** – Statement on Auditing Standards (SAS)
- Attestation-based engagement
- Follows the core tenets of AT101:
  - Management's assertion
  - Suitable criteria
  - Appropriate subject matter
  - Intended users

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Key Elements and Discussion Points

•Key elements and discussion points:

- Format of the report
- Management assertion
- Assertion basis and risk assessment
- Scope of controls
- Subservice organizations
- Internal audit
- Effective date and early adoption
- Single user reports
- User entities and auditors
- Global aspects

- Report will contain the same components :
  - *Opinion*
  - *Description of System and Controls*
  - *Control Objectives, Activities, Testing, and Results*
- Report will also include management's assertion, placement of which may vary
- Opinion will "look and feel" very different
- All three elements cover the entire period of the report:
  - *SAS 70 only required an evaluation of fairness of presentation and suitability of design at the "as-of" date for the report. These will now be evaluated throughout the period.*

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The Service Auditor's Report

- Scope:
  - Initial definition of the "system" covered in the report including period covered.
- Service Organization's Responsibilities:
  - References management's assertion as well as responsibility over control objectives, identifying risks, and implementing and maintaining controls designed to meet the objectives.
- Service Auditor's Responsibilities:
  - Examine system and express an opinion over the period indicated in accordance with professional standards.
- Inherent Limitations:
  - A statement of the inherent limitations of the potential effectiveness of controls and of the risk of projecting to the future any evaluation of the service organization's system.
- Opinion:
  - The system is fairly presented, suitably designed, and operating effectively for the period.
- Description of tests of controls
- Restricted Use

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Paraphrased:

We (management) have prepared this description of the "system" and confirm:

•Presents fairly the "system" used for processing transactions for user entities and includes all relevant information.

•Relevant changes for the period are included.

•Controls are suitably designed, implemented, and operating effectively for the period to achieve the specified control objectives. Criteria used were:

•Risks that threaten the achievement of the control objectives

•Controls identified were designed to mitigate those risks

•Controls were consistently applied by individuals with appropriate authority.

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- Basis for Assertion:
  - *Not intended to be "SOX-Like"; however, must be more than passive interest in effectiveness.*
  - *Monitoring activities may provide evidence (assesses effectiveness over time).*
  - *Can be ongoing monitoring or separate evaluations, or combination of the two.*
  - *Could include Internal Audit or ongoing monitoring for information provided by external parties (regulators, customers, etc.).*
  - *Consider risks to achieving objectives and how management would identify failures.*
- Risk Assessment:
  - *Formal or informal process for evaluating risks and likelihood of achieving the control objectives.*
  - *Assists with the evaluation of controls and assessing management's process and basis for assertion.*

(See Appendix for references to the Standard)

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- The focus of this SSAE is on controls at service organizations LIKELY to be relevant to user entities' internal control over financial reporting.
- Not intended for nonfinancial systems
- The new standard may be "helpful" to a practitioner performing an engagement under AT 101 to report on controls at a service organization (provides a framework that may be formalized):
  - *Suitable and available evaluation criteria must exist*
  - *The needs of the user of the report must be identified*
  - *The relevance of the control objectives to nonfinancial reporting must be considered*
  - *Other matters*

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- Subservice Provider:
  - *Entity used by Service Organization that performs some of the services provided to user entities that are likely to be relevant to those user entities' internal control over financial reporting.*
  - *In other words, another provider that is part of the "system."*
- Inclusive Method or Carve-out Method:
  - *The inclusive method requires that the management of the subservice provider meet all the requirements of the service organization, including providing an assertion on the relevant controls (and having a basis for the assertion).*
  - *When a subservicer's controls are not sufficient to achieve a control objective on its own, management of the subservice organization may be unwilling or unable to provide an assertion. In such situations, the subservice organization must be carved out.*

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- Relevance of Internal Audit must be understood:
  - *Service auditor should understand the relevance of Internal Audit to the engagement. Internal Audit work may be assessed and evaluated for use in performing the work.*
- If the work of Internal Audit is used, it must be disclosed in report:
  - *May be included as introductory material to the description of tests of controls*
  - *Certain tests attributable to Internal Audit may be included.*

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- Effective Date:
  - The effective date for the new standard is for reporting periods ending on or after **June 15, 2011.**
  - Since service auditor reports typically cover 6–12 months, reports may fall under the new standard as early as 2nd quarter of 2010.
- Early Adoption:
  - IAASB and ASB are permitting early adoption; reports may be issued now under the new standard; however, additional AICPA guidance (Attest Guide) is not expected to be published until mid 2010.
  - Between now and June 15, 2011, we may see some service organizations choose to be early adopters.

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- Some reports are designated for the "system" of processing transactions for an individual user entity:
  - *Designation of a single user entity does not remove management's responsibility to assess the design of the controls to meet the control objectives, and provide the corresponding assertion.*
  - *Impacts management's risk assessment and evaluation of controls.*
  - *Consider procedures applied to ensure complete and accurate reporting to the user entity, and consider the appropriate control objectives.*

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- Reports are intended for use by the service organization, its user entities, and the independent auditors of the user entities.
  - *The reports are intended to be used by clients <u>that used the system</u> during that period to understand the "system" in place and determine its effectiveness.*
- The independent auditor (of user entities) may use these reports in planning a risk assessment and performing an audit for the user entity of a service organization.
  - *Auditing standard (SAS) will address user auditor's consideration of internal control when processing is performed by a service organization*
  - *Consistent guidance with the PCAOB Standard #5 (Appendix B) for use in a SOX Audit.*

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- ISAE 3402 is the global standard (December 2009)
- The U.S. Standard is substantially the same as the International Standard, with minor differences to reflect U.S.-based standards and definitions:
  - ***Intentional acts*** *identified under the U.S. standard must be specifically evaluated for overall impact.*
  - *The ISAE allows for the evaluation of exceptions as* ***anomalies*** *that may be excluded from the report.*
  - *The U.S. standard has some additional requirements related to* ***subsequent events****.*
  - *The U.S. standard includes additional language on* ***intended use.***
- Anticipated that most countries will adopt the international standards, or adopt a similar standard.
  - Example: Canada is expected to replace their 5970 standard (SAS 70 equivalent) with a similar standard to the United States.
  - Example: The United Kingdom is expected to adopt a standard that includes all the elements of the global standard, but may include additional performance requirements.

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What Should Service Organizations Do?

1. Understand the change:
   - Assertion requirement
   - Review your risk assessment processes, controls and control objectives, and details related to monitoring.
2. Engage your service auditor:
   - Understand anticipated impact on their report and their work
   - Early adoption and implications
   - Impact of subservice organizations.
3. Plan for the transition:
   - Conduct internal training
   - Coordinate with legal department, contracts may need to change
   - Develop customer communication plan, educate them on current changes, and prepare them for differences
   - Review internal processes and current report(s).

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Frequent Questions

Given that many of today's service organizations have processing facilities in multiple countries around the world, which standard must the service auditor follow – United States or International?

- Simply put, service auditors must follow their respective professional standards
- For those reports issued in the United States, the service auditor must issue the report in accordance with AICPA standards (SSAE #16).
- Reports issued outside the United States would be issued in accordance with applicable standards for the service auditor's respective country or jurisdiction.

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Frequent Questions (continued)

- Is there expected to be a transition period during which both SAS 70 reports and reports under the new standard are acceptable?
  - It is the intent of both Boards (the IAASB and the ASB in the United States) that both versions of the standard be adopted with the same effective date. However, early adoption will be permitted under the new standards. As a result, there may be instances, prior to mandatory adoption, where SAS 70 reports, as well as the new reports, may be issued. Thus, we may begin to see reports issued under the new standard in the latter half of 2010.

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Frequent Questions (continued)

- Will there be an impact on the degree of time and effort expended by the service auditor in the year of adoption of the new standard? Will there be any ongoing impact?
  - We anticipate that the underlying effort to perform an assurance engagement will affect the service organization to varying degrees, depending upon their particular environment. For example, if subservice organizations are utilized and will be addressed using the inclusive method, a greater degree of effort may be required by the service auditor to address the requirements of the new standard.

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Frequent Questions (continued)

- I have heard that the standard permits reporting on nonfinancial systems; i.e., systems that are not part of the user organization's information system relevant to financial reporting. Is this true?
  - No. This standard is only intended to address a report on controls that are likely to be relevant to user entities' internal control over financial reporting.
  - However, the service auditor can issue a separate report on controls over nonfinancial systems but must do so under existing attestation standards.
    - Such reports may be expanded to include many of the same components included under SSAE #16. The guidance in the new standard may be <u>helpful</u> to a practitioner performing such engagement.

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Frequent Questions (continued)

- My service organization's system uses another organization to perform some of the services provided to user entities that are likely to be relevant to those user entities' internal controls over financial reporting. How do the new standards impact reporting for these subservice providers?
  - Similar to the SAS 70 standard, the new standard requires that the service auditor's opinion indicate whether the scope of the report uses a "carve-out" or "inclusive" method for dealing with the subservice organization:
    - In a "carve-out," the subservice organization's relevant objectives and related controls are excluded from the scope; however, the system of controls should include the service organization's controls that monitor the controls for the subservice provider.
    - The "inclusive" method requires that the relevant control objectives and related controls are included in the report and examination. The requirements of the standard for management's assertion also apply to the services provided by the subservice organization. If the auditor is unable to obtain an assertion from the subservice organization, the report may not be issued using the inclusive method. The service auditor is also required to perform procedures on the controls of the subservice organization.

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Q&A

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Contact:

David Lewis

rdlewis@kpmg.com

Alya Gennaro

agennaro@kpmg.com

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