

8 February 2011

Auditing and Assurance Standards Board
PO Box 204
Collins Street West
Melbourne Vic 8007

Dear Members

**GS007 Audit Implications of the Use of Service Organisations for Investment Management Services
Feedback to AUASB**

Introduction

Ernst & Young provides this submission to the Auditing and Assurance Standards Board (AUASB) in response to the invitation to comment on our experiences in implementing GS007 "Audit Implications of the Use of Service Organisations for Investment Management Services" (GS007).

E&Y comments on the four areas identified by the AUASB as follows:

- 1. The extent to which in their experience investment management service organisations are obtaining Service Auditor's reports under GS007 and the extent to which User entities or User Auditors are requesting those reports**

E&Y believe there is general acceptance that investment management service organisations will request or provide a GS007 as part of their dealings in the investment management industry in Australia.

The two sub areas of the investment management industry where the take up has been less than uniform are the Fund Managers and Property Managers.

In regards to the Fund Managers their reluctance is generally driven by the economics of their organisation and the costs of providing a GS007. This combined with the existence of the ASIC Class Order 02/294 for Investor Directed Portfolio Services (IDPS) regime has meant there can be situations where a GS007 was felt to be an unnecessary additional requirement.

In the Property Management industry the cost burden appears to be a barrier to the general acceptance of the GS007.

- 2. Are Service Auditors' reports with respect to investment management service organisations providing the audit evidence User Auditors require for the audit of User entities' financial reports?**

E&Y experience is that there are generally very few inquiries from User Auditors with regards to the issue of a GS007 in regards to the extent of audit evidence.

Where there are inadequacies, User Auditors have tended to undertake their own additional audit procedures rather than seeking clarification from the GS007 Auditor.

However, we are now seeing evidence of investment management organisations seeking to reduce the burden of multiple audit inquiries by encouraging User Auditors to identify their concerns. In this way E&Y hope to improve the disclosure in the GS007 and reduce the number of User Auditor inquiries and visits to the service organisation.

We have also noted that the linkages between the GS007 and the Financial Statement Assertions upon which the User Auditor is seeking to gain comfort, is not universally well understood by the User Auditors.

In addition, User Auditors often have difficulty understanding the extent of outsourcing undertaken by the GS007 service organisations. Additional minimum disclosure guidance on this topic would be beneficial in any revision of the GS007. In particular, clarification of the definitions and the responsibilities of the parties would assist User Auditors to better understand the control environment upon which E&Y are seeking to rely.

The opportunity to improve this area should be facilitated by the introduction of the ASAE 3402 standard. We would recommend the GS007 be enhanced to include some decision trees to help the User Auditor make the link between the new ASAE 3402 standard and the GS007 guidance.

3. Are the control objectives comprehensive, relevant and clear for each service area? If not, please provide details of any suggested amendments or additional objectives.

As a general rule the control objectives in the GS007 have been well received as a set of minimum standards. We believe this is a major advantage over other auditing environments (international) where discretion can lead to a lack of disclosure.

The areas we believe should be considered by the AUASB for refinement are:

a) Monitoring of outsourced sub service providers

This is becoming important in light of the growing off-shoring activities and the preference for the "carve-out" method under par 9(a) of ASAE 3402.

We would recommend the minimum control objectives included in the GS007 be expanded to include Controls Reports, Financial Statements, Regulatory Filings and other E&Y monitoring controls exercised by the service organisation over their sub service providers.

b) Unit Pricing/Crediting Rates

This area continues to be the subject of commercial disputes between Investment Management Organisations and their clients within the investment management industry. On many occasions, there are claims for compensation due to alleged breakdown in internal controls.

Accordingly we believe the AUASB should consider this issue and clarify the role and responsibility of the GS007 Service Auditor within the Guidance to assist the auditing profession in understanding their role and explaining it to their clients. This may require clarification of GS007 paragraph 76 (f) i to highlight the alignment between services provided by service organisations and their GS007.

c) Compliance Requirements

Compliance is only briefly referred to in par 56 of the GS007 as the Guidance is primarily focussed on the Financial Statements.

However, the responsibility of the User Auditor is often extended to compliance with the relevant legislation eg: SIS Act for the Superannuation Industry. We would recommend the AUASB considers this issue and clarifies how the User Auditor should approach this part of their responsibilities.

d) Taxation Reporting

This area continues to challenge the investment management industry due to the complexity of the legislative environment. We would recommend the AUASB seek input from the relevant tax practitioners, to ensure the GS007 continues to provide the appropriate level of information to assist User Auditors. We have noted that User Auditors are often faced with difficult tasks regarding tax balances eg: Deferred Tax Assets supported by complex CGT tax records at custodians.

4. Do the six services addressed by GS007 cover the investment management services which may be part of the User entity's information system, including business processes, relevant to financial reporting?

The services included within the GS007 generally cover the investment management services provided within the industry. The areas for clarification are noted above under our response to item 3.

5. Additional Suggestions

In addition, E&Y would like to bring the following two additional suggestions to the attention of AUASB.

- a) Complementary User entity controls as defined in ASAE 3402 par 9 (b) are an essential part of the internal controls framework within which the GS007 operates. Accordingly the AUASB should consider the roles and responsibilities of the Service Auditor in arriving at the most appropriate description of those controls, as in many cases they need to be complementary to the assessment of design effectiveness at the Service Organisation.

A good example of this is the Failed Trades Reporting and Stale Price Reporting practices of the Custodians to the Investment Management Industry. In both cases E&Y rely on reports to clients without the need for positive confirmation between the parties. Accordingly, the need for clearly defined User controls would improve the clarity of the internal controls framework for the User Auditor.

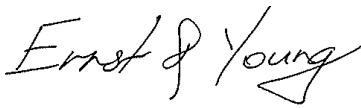
- b) Management responsibility for the testing of controls during the period covered by the audit is another area that we believe could be improved. We believe it is appropriate for the GS007 to provide guidance with regards to management's testing of the controls to be the subject of their sign-off. For example, whether management should test controls individually, can rely on internal audit, or form some other judgement as to the effectiveness of the control procedures included in the Management Report.

6. Conclusion

E&Y completes a number of the more significant GS007 reports within the Australian Investment Management industry and is fully committed to refining the GS007 to be a world class audit tool for the Australian Capital Market.

In the event you have any further questions or we can be of any further assistance, please do not hesitate to contact Martin Walsh on 03 9288 8368 or Graeme McKenzie on 02 9248 4689.

Yours sincerely

A handwritten signature in cursive script that reads 'Ernst & Young'.

Ernst & Young