



Ms Claire Grayston
Auditing and Assurance Standards Board
Level 7
600 Bourke Street
Melbourne VIC 3000

03 February 2011

Dear Ms Grayston

Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services (GS 007)*

We appreciate the opportunity to comment on GS 007 and to contribute to the continued improvement of the Australian Auditing Standards.

Our letter to you dated 12 November 2009 contained preliminary feedback from our practitioners on the first year of implementation of GS007. A copy of that letter is attached at Appendix 1. In addition to these comments, our further feedback is set out below.

Overall we strongly support the current approach adopted in GS 007, in particular the provision of minimum control objectives and the preparation of Special Purpose Service Auditor's reports. GS 007 has increased the quality and consistency of audit evidence available to service auditors, and has been well accepted by the industry. We also support the proposal by the AUASB to revise GS 007 to "*address the feedback obtained to date and to anchor to the new suite of clarity standards.*"

A. Interpretation and application of the Guidance Statement

ASAE 3402 Assurance Reports on Controls at a Service Organisation

ASAE 3402 Assurance Reports on Controls at a Service Organisation was issued in June 2010 and contains certain information similar to that in GS 007, for example an example engagement letter and an example service auditor's assurance report.

Wherever possible, we would welcome the harmonisation of content set out in the example engagement letters and service auditor's assurance reports in GS 007 with ASAE 3402.

PwC, ABN 52 780 433 757

*Darling Park Tower 2, 201 Sussex Street, GPO BOX 2650, SYDNEY NSW 1171
DX 77 Sydney, Australia
T +61 2 8266 0000, F +61 2 8266 9999, www.pwc.com.au*

Liability limited by a scheme approved under Professional Standards Legislation.



ASA 800 *The Auditor's Report on Special Purpose Audit Engagements*

The revised paragraph A14 of ASA 800 requires inclusion of an emphasis of matter paragraph for special purpose financial reports. As Reports on Specified Assertions in GS 007 are reports on special purpose financial reports, we envisage the new requirement in ASA 800 applies and we recommend GS 007 is updated to reflect this.

Control Objectives for Investment Management Services

Appendix 2, Section B of GS 007 contains minimum Control Objectives for each Investment Management Service set out in the GS. We believe the notion of having minimum control objectives for each Investment Management Service has resulted in a significant improvement in the quality of audit evidence provided to service auditors due to the increased comparability between Service Organisation reports (when compared to reports previously issued under AGS 1026 *Reporting on Control Procedures at outsourcing Entities*), and the improved content of many Service Organisation reports since GS 007 became effective.

Multiple Investment Management Service considerations

The Investment Management Service sections in Appendix 2 of the GS007 are currently represented as mutually inclusive, to be factored into reports wherever offered by the service provider. There is currently no consideration for where multiple investment management services offered by the same service provider result in conflict of interest concerns. For example in the US, the amendment to SEC Custody Rule 206(a) requires additional internal controls to be assessed for entities involved in the provision of both asset management and custody services. These internal controls can be included in a separate report or built into existing SAS70 reports.

We recommend that GS007 be revised to require that when two or more investment services are offered that may give rise to a conflict of interest, additional control objectives are included to demonstrate how those conflicts are managed. Those that are involved in the provision of asset management and custody services should be given appropriate time to address the documentation of such controls prior to an amendment becoming effective.

Application of GS 007

Where a service organisation does not prepare a Controls Report and the user auditor has determined the service organisation's activities are significant to the user entity and the audit, the user auditor should determine what alternative procedures can be performed to obtain the desired level of assurance. If the service auditor is unable to provide the level of assurance required by the user auditor, the user auditor's procedures may require access to the service organisation. If this is not possible, the user auditor should consider the implications for the audit opinion of the user entity.

We have observed that the preparers and auditors of financial statements often use or rely on information provided by prime brokerage and clearing agencies, which are not currently defined as Investment Management Services in GS007. Further, we have observed prime brokerage entities contract for SAS70 services with auditors in the United States in response to requests from user organisations. In many cases, such services are similar to custody services. We would recommend that the AUASB consult with its consultative committee as to whether such services should be specifically referred to in GS007.



Types of Special Purpose Service auditors reports

In practice the most common format of Special Purpose Service Auditor's report is either:

- A Service Auditor's report on Specified Assertions, or
- An agreed upon procedures report for certain assets (typically where the audit evidence available is located partly at the service entity and partly at the user).

We recommend that GS 007 remove reference to a Service Auditor's report on a Statement and acknowledge that agreed upon procedures reports may also be appropriate in certain circumstances.

B. Interpretation of prescribed control objectives in Section B of GS007

Feedback on certain of these Control Objectives is set out in our letter dated 12 November 2009. In addition, we make the following observations:

Gaps

Section A. Custody

There is currently no control objective surrounding the reinvestment of securities lending collateral. Ensuring that collateral is reinvested in line with client investment restrictions is as important as lending in line with client lending restrictions. The objective could read *"Collateral is completely and accurately invested in accordance with the lender agreement"*.

Corporate actions

Objectives A6 / B7 "Corporate events and voting instructions are identified, processed and recorded on a timely basis" and E4 "Corporate actions are processed and recorded accurately and on a timely basis" are not inclusive of all necessary controls required in addressing the completeness and accuracy of corporate actions.

We suggest this control objective includes reference to the event being actioned (ie. identification and notification of affected holders, follow-up on client responses/instructions). The proposed objective could read *"Corporate actions are identified, actioned, processed, and recorded accurately on a timely basis"*.

Safeguarding assets

Objective A14 and A15 are expressed differently to objective B15. In each case, the intention is to ensure that client monies are appropriately safeguarded and segregated from assets of other clients, and assets of the custodian.

We suggest that these control objectives be harmonised to the following two revised control objectives that would apply to both custody and investment management:

Assets held (including investments held with depositories, cash and physically held assets) are safeguarded from loss, misappropriation and unauthorised use.



Assets held are appropriately registered and segregated from the [custodian / investment manager's] own assets.

Relevance

Static data

Objectives A11 / B10 / C13 / E7 / F10 "Changes to non-monetary static data (for example, address changes and changes in allocation instructions) are authorised and correctly recorded on a timely basis"

Most changes to non-monetary static data are unlikely to have any impact on the financial statements, including the scenario in which they may be unauthorised or inaccurately input. It is recommended that this control be changed to focus on significant static data changes (bank details related to electronic and cheque disbursements, standing settlement instructions, etc) in aligning with the purpose of GS007. The proposed objective could read *"Changes to significant non-monetary static data (for example, address changes and changes in allocation instructions) are authorised and correctly recorded on a timely basis"*

Duplication

Section G. Information Technology

Our interpretation is that *Objective G3 "Logical access to computer systems, programs, master data, transaction data and parameters, including access by administrators to applications, databases, systems and networks is restricted to authorised individuals"* fully subsumes *Objective G1 "Client data is appropriately stored to ensure security and protection from unauthorised use"* so that Objective G1 is duplicative and could be removed.

We also believe the removal of this G1 Objective surrounding client data will reduce the susceptibility of this section to the inclusion of privacy controls which we would regard as ancillary to the financial statements and not aligned with the purpose of GS007.

Our interpretation is that *Objective G5 "IT processing is authorised and scheduled appropriately and exceptions are identified and resolved in a timely manner"* encapsulates *Objective G10 "Batch processing is complete, accurate and timely"*, so that Objective G10 is duplicative and could be removed.

Clarity

Section F. Registry

Objective F3 "Pooled fund unit holder activity is clearly established and recorded completely, accurately and in a timely manner"

We would re-iterate the comments of our previous letter around the definition of pooled funds. Our understanding is that this control objective will be removed from future iterations of the guidance. In the event that it is not, we would recommend a requirement for disclosure in the report as to which control activities have been tested in a mandate specific fashion and which have been tested as a pooled fund control.



Section E. Investment Administration

Objective E18 "Distribution income is complete and accurate and is reported to clients on a timely basis"

We would re-iterate the comments of our previous letter around the definition of distributions. Our interpretation is that distributions refers to the receipt and processing of annual tax distribution statements, in which case this control objective is of limited value to user auditors due to the timing of the GS007 controls report (e.g. for a GS007 controls report with a year end of 30 June 2010, the controls tested would be over the preparation of annual statements for the June 2009 year end).

We have also observed significant differences in practice on the approach to this objective, along a spectrum of control activities from the full end-to-end tax distribution process through to a single control activity regarding the final sign-off on tax statements. We recommend that the scope and purpose of this objective be discussed with the AUASB's Project Advisory Group and amended accordingly.

Objective F4 "Documents received are checked, sorted and distributed for processing in a timely manner"

Many users have struggled to understand what "Documents" are being referred to in this context. As this control objective is in the Registry section, we have interpreted this to include unit holder applications, redemptions and switches. The wording should be revised to make clear which documents are intended.

Aggregation

Section B. Asset Management

As asset investment guidelines and restrictions are in practice commonly contained within the client agreement, it follows that Objective B3 "*Asset investment guidelines and restrictions are established and agreed prior to investment activity*" is subsumed by Objective B2 "*Complete and authorised client agreements are established prior to initiating investment activity*". We recommend that objective B3 be removed and objective B2 be updated to read "*Complete and authorised client agreements (including investment guidelines and restrictions) are established prior to initiating investment activity*".

We would be pleased to discuss our comments with you. Please contact Dan Jowett on (02) 8266 0295 or myself on (02) 8266 7657 should you require any further information.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Victor Clarke', written over a light grey rectangular background.

Victor Clarke
Partner



Appendix 1



Ms Claire Grayston
Auditing and Assurance Standards Board
Level 4
530 Collins Street
Melbourne VIC 3000

PriceWaterhouseCoopers
ADN 52 700 433 757

Freshwater Place
2 Southbank Boulevard
SOUTH BANK VIC 3006
GPO Box 1331L
MELBOURNE VIC 3001
DX 77
Telephone 61 3 8603 1000
Facsimile 61 3 8603 1000
Website: www.pwc.com/au

12 November 2009

Dear Ms Grayston

Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services*

We appreciate the opportunity to comment on the above mentioned Guidance Statement and to contribute to the continued improvement of the Australian Auditing Standards.

We support the overall approach in GS007 and feel that year one implementation of this GS has been successful. Following year one implementation, we have collated feedback from our practitioners, which is split into the following areas:

- a. Interpretation of the GS
- b. Ambiguous control objectives
- c. Special purpose audit engagements

Further information on this feedback is listed in Appendix 1.

We would be pleased to discuss our comments with you. Please contact Nicola Murdoch on (03) 8603 2330 or myself on (03) 8603 3649 should you require any further information.

Yours sincerely

Bill Edge
Partner
OneFirm Risk & Quality Leader

Liability limited by a scheme approved under Professional Standards Legislation



Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services*

Appendix 1

A. Interpretation and application of the Guidance Statement

(i) Use of sub service organisation

Paragraph 84 states "In certain limited circumstances, the user entity may agree that the sub-service organisation's relevant control objectives and allied controls are to be excluded from the service organisation's description and from the scope of the service auditor's engagement".

In practice we understand that to date the exclusive method has been used in the majority of cases and not in 'certain limited circumstances' as the GS implies. This arises due to factors such as:

- Use of sub-service organisations from outside Australia which are not subject to GS007 requirements;
- Restrictions imposed by either the sub-service organisation or their auditor on circulation of their GS007 report;
- Use of multiple sub-service organisations;
- Different year ends.

Our preference would be for the GS to require the client to document the control procedures they follow in monitoring the sub-service organisation.

(ii) Exceptions and Qualification

There has been some debate among practitioners as to in which circumstances exceptions reported would result in a qualification.

Our interpretation of the requirements of the standards, particularly ASAE3000 and AGS1042 is that materiality should be assessed in terms of the overall objectives in the report, and not be assessed at the level of each individual control objective. It would be useful if the Auditing and Assurance Standards Board (AUASB) could confirm this interpretation in GS007.

We also believe it would be useful to provide further guidance for the user for assessing and responding to control weaknesses at a service organisation.

(iii) Application of GS 007

GS007 is written specifically for the purpose of providing assurance to user auditors of entities which use service organisations to provide investment management services. Whilst it is a guidance statement, in practice we consider it would be difficult for a service organisation auditor to issue a report on a service organisation's controls over its investment management services which is intended to be provided to a user auditor without reference to GS007. We recommend that this point be explicitly made in the introductory paragraphs of GS007.



Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services*

Further, prime brokerage organisations may hold investment fund assets as security for fund transactions and provide certain settlement, transaction recording and portfolio reporting services to the investment management industry in addition to core brokerage services. While the nature of the contractual arrangement between an investment fund and prime broker may be different to that of a typical custodian or administrator, we have observed that the preparers and auditors of fund financial statements often use or rely on information provided by prime brokers.

We recommend that consideration be given the use of information provided by prime brokers in the preparation and audit of fund financial statements and that additional guidance be included in GS007 where appropriate

(iv) User organisations ancillary uses of GS007 reports

We are aware that many user organisations also seek assurance on controls adopted at service organisations for other purposes, including assessment of the performance of the service organisation or as part of a compliance framework. In many cases they place reliance on GS007 controls reports for such purposes, even though the report is not designed for this purpose, whilst in other circumstances, a separate report is provided.

We recommend that GS007 be amended to:

- Clearly state the purpose for which GS007 reports are designed and their limitations, both in the body of the guidance statement and in the example reports
- Recognise that in certain circumstances a separate report may be required to meet the ancillary purposes, and confirm that such a report is not required to be prepared under GS007, but should make it clear that it is not in accordance with GS007, and does not address all of the objectives required under GS007, and as such may not represent sufficient or appropriate audit evidence for a user auditor

B. Interpretation of prescribed control objectives in Section B of GS007

(i) Modification of the standard objectives

There has been some debate in the industry as to whether it is acceptable to modify the wording of the GS007 objectives set out in Section B. It has been argued that paragraph 75 of GS007 effectively "mandates" the minimum objectives in Section B unmodified.



Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services*

Our position has been:

- Modifications to use language appropriate to the particular circumstances of the individual service organisation are acceptable,
- However such modifications can only "clarify" the objective to the particular services provided, or expand on the objective, they cannot "reduce" the scope of the objective

It would be useful if the AUASB could clarify its intent on the extent to which the words in Section B are mandated.

(ii) Investment Administration

- *Objective E16 "Annual reports and accounts are prepared in accordance with applicable laws and regulations"*
In practice this control objective has proven to be of limited or nil value to user auditors because of the timing of the GS007 controls report (eg for a GS007 controls report with a year end of 30 June 2010, the controls tested would be over the preparation of annual reports and accounts for the June 2009 year end). We recommend that this control objective be removed.
- *Objective E18 "Distribution income is complete and accurate and is reported to clients on a timely basis"*
This control objective has been interpreted differently by different service organisations. As it sits within the taxation section, our interpretation is that it relates to the receipt and processing of annual tax distribution statements and the related control procedure(s) should address this.

Other interpretations we have seen are:

- that it relates to receipt of cash distributions (in our view this is covered by control objective E.8)
- that it relates to determination of distribution amounts to investors by the fund (given the words "reported to clients"

We suggest that the AUASB clarify its intent.

- *Objective E20 "Tax information...is complete and accurate and calculated on a timely basis"*
Our interpretation is that this objective relates to the controls over the calculation of the underlying data for inclusion in the calculation of the taxable income of the fund which is addressed in control objective E21. We recommend that this be confirmed in the wording of the objective by amending the objective to state "Tax information (including.....) used in the preparation of the tax computation (see control objective E21) is complete and accurate and calculated on a timely basis."



Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services*

(iii) Registry

- *Objective F3 "Pooled fund unit holder activity is clearly established and recorded completely, accurately and in a timely manner"*
Many users have struggled to understand what a "Pooled Fund" is in this context. The control objective seems to be a duplication of many of the other control objectives for unithised funds, and we recommend that it be deleted.
- *Objective F8 "Shares / units issued do not exceed the authorised number of shared in an issue and the number of new shared / units represented corresponds to the number of cancelled shares / units"*
GS007 has a broad application and was written to cover the activities of many different service organisations and user organisations. Our interpretation is that F8 was written for user organisations with a fixed authorised capital only (typically listed companies that utilise external Corporate Registry functions e.g. Computershare). We suggest that the AUASB confirm this understanding.
- *Objective F11 "Registrar records accurately reflect shares, units and cash held by third parties"*
This is difficult to interpret for a 'typical' third party administrator in funds management. In such scenarios, the objective is likely to be addressed through a combination of other control objectives / procedures in GS007. We suggest that the AUASB either delete the objective or clarify its intent.

(iv) Custody, Asset Management, Property Management, Superannuation Member Administration and Investment Administration

- *Objectives A1 / B1 / C1 / D1 / E1 "Accounts are set up completely and accurately in accordance with client agreements and applicable regulations"*
Often there are no applicable regulations. As this is the standard wording, we have encouraged clients to follow this wording and stay silent on the regulations, which we would not report as an exception.

It would be useful if the AUASB could add the words "if applicable" to the objective.



Comments on Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services*

C. Special purpose audit engagements

The process for special purpose audit engagements was not changed significantly by GS007 from the previous model, and we are not aware of any significant issues in practice.

We are aware that there is a variety of practices between different user auditors (both in the same firm and between firms) with regard to whether they accept investment statements for unit trust investments or require external confirmations. However we do not consider this is an issue on which additional guidance is appropriate given the wide variety of possible scenarios, and decisions on the nature and quantum of audit evidence is a matter for each individual auditor given the circumstances of the individual entity.