

**GS 007**

(August 2011)

**Guidance Statement GS 007**  
*Audit Implications of the use  
of Service Organisations for  
Investment Management  
Services*

Issued by the **Auditing and Assurance Standards Board**



**Australian Government**

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**Auditing and Assurance Standards Board**

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**AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) formulates Guidance Statement GS 007 *Audit Implications of the use of Service Organisations for Investment Management Services*, pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001*, for the purposes of providing guidance on auditing and assurance matters.

This Guidance Statement provides guidance to assist the auditor to fulfil the objectives of the audit or assurance engagement. It includes explanatory material on specific matters for the purposes of understanding and complying with AUASB Standards. The auditor exercises professional judgement when using this Guidance Statement.

The Guidance Statement does not prescribe or create new requirements.

Dated: <TypeHere>

M H Kelsall  
Chairman - AUASB

## **GUIDANCE STATEMENT GS 007**

### ***Audit Implications of the use of Service Organisations for Investment Management Services***

#### **Application**

1. This Guidance Statement has been formulated by the Auditing and Assurance Standards Board (AUASB) to provide guidance to auditors on:
  - (a) auditors (user auditors) of a financial report of an entity (user entity) which uses a service organisation to provide investment management services; and
  - (b) auditors (service auditors) of those service organisations, who provide reports on controls or financial information which may be used as audit evidence in the audit of the user entity's financial report.

#### **Issuance Date**

2. This Guidance statement is issued on xx xxxx 2011 by the AUASB and replaces 007 *Audit Implications of the use of Service Organisations for Investment Management Services*, issued in March 2008. It is operative for reporting periods commencing on or after 1 October 2011.

#### **Introduction**

3. This Guidance Statement applies to:
  - (a) The user auditor engaged to audit the financial report of an entity (user entity) that uses a third party service organisation to provide investment management services, where:

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- (i) the services provided are part of the user entity's information system, including related business processes, relevant to financial reporting<sup>1</sup>;
- (ii) audit evidence required by the user auditor, regarding internal controls and/or assertions, is located at the service organisation; and
- (iii) reports on controls at the service organisation and/or a service auditor's report on specified assertions or a financial statement of the user entity's balances or transactions relating to the services provided by the service organisation are available.

Part A of this Guidance Statement (paragraphs 15-59) provides guidance to the user auditor on the application of Auditing Standard ASA 402, when using a service auditor's report on controls and/or Australian Auditing Standards, when using a service auditor's report on financial information, in the above circumstances.

- (b) The service auditor engaged to report on controls and/or financial information relating to components of user entities for which investment management services are provided by the service organisation.

Part B of this Guidance Statement (paragraphs 60-144) provides guidance to the service auditor on the application of Standard on Assurance Engagements ASAE 3402 when reporting on controls and Auditing Standard ASA 805<sup>2</sup> when reporting on financial information.

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<sup>1</sup> See ASA 402 *Audit Considerations Relating to an Entity Using a Service Organisation*, paragraph 3 which specifies when the service organisation's services are part of the user entity's information system, including related business processes, relevant to financial reporting.

<sup>2</sup> See ASA 805 *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*.

## **Types of Reports**

4. This Guidance Statement provides guidance for the preparation and use as audit evidence of the following reports:
- (a) Reports on the description and design of controls at a service organisation (Type 1 report)<sup>3</sup> or description, design and operating effectiveness of controls at a service organisation (Type 2 report),<sup>4</sup> relating to the service organisation's system over the investment management services provided to user entities, prepared in accordance with ASAE 3402
  - (b) Service auditor's reports on financial information, prepared in accordance with ASA 805,<sup>5</sup> comprising either:
    - (i) a service auditor's report on specified assertions regarding balances or transactions of the user entity reported in a financial statement by the service organisation, which provides investment management services, ("Service Auditor's Report on Specified Assertions"); or
    - (ii) a service auditor's report on a financial statement of the user entity's balances or transactions ("Statement") reported by the service organisation which provides investment management services ("Service Auditor's Report on a Statement").
5. Type 1 and 2 reports on controls comprise:<sup>6</sup>
- (a) A service organisation's description of its investment management services system, including identification of: the services covered; the date or period to which the

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<sup>3</sup> See ASAE 3420, paragraph 9(j).

<sup>4</sup> See ASAE 3420, paragraph 9(k).

<sup>5</sup> ASA 800 is also applicable if the financial information is a financial report or complete set of financial statements prepared in accordance with a special purpose framework.

<sup>6</sup> See ASAE 3402, paragraph 9(j) & 9(k).

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description relates; control objectives, including the control objectives listed in Appendix 2 Example 2 of this Guidance Statement for the relevant investment management services provided; and related controls.<sup>7</sup>

- (b) A written assertion by the service organisation that, in all material respects, and based on suitable criteria: the description fairly presents the service organisation's system as designed and implemented and that the controls related to the control objectives stated in the service organisation's description of its system were suitably designed as at the specified date, for a Type 1 Report, or throughout the period, for a Type 2 Report. In addition, for a Type 2 Report, an assertion that the controls operated effectively throughout the specified period.
  - (c) A service auditor's assurance report that conveys reasonable assurance about the service organisation's assertions, including for Type 2 Reports, a description of the tests of controls and the results thereof
6. The use of a Type 1 report by a user auditor is limited to understanding the entity in accordance with Auditing Standard ASA 315<sup>8</sup>, whereas a Type 2 report may also be used by a user auditor in responding to assessed risks in accordance with Auditing Standard ASA 330.<sup>9</sup>
7. The following table, entitled *Table 1: Service Auditor's Reports*, outlines the context in which each of these reports is prepared and used as audit evidence. Table 1 lists the reports included in this Guidance Statement, the subject matter covered by each report, the circumstances for which each report may be useful to user auditors, standards relevant to the preparation and use of each report and

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<sup>7</sup> See ASAE 3402, paragraph 9(n).

<sup>8</sup> See ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

<sup>9</sup> See ASA 330 *The Auditor's Responses to Assessed Risks*.

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**Table 1: Service Auditor’s Reports**

<b>Title of Report</b>	<b>Subject Matter Covered by Report</b>	<b>Circumstances for Which Report is Used by User Auditors</b>	<b>Relevant Standards</b>	<b>Appendix Reference for Examples</b>
Reports on Controls				
1. Type 1 Report	Description and design of controls at the service organisation.	Planning: Obtaining an understanding of the user entity and its environment, including controls over services provided by the service organisation, in order to assess the risk of material misstatement and design further audit procedures. This report cannot be relied on to reduce substantive procedures.	User Auditor: ASA 402 & ASA 315 Service Auditor: ASAE 3402	Engagement letter: Appendix 1 Example 1 Service Auditor’s Type 1 Report: No example provided as this report is not likely to meet the needs of all user auditors.
2. Type 2 Report	Description, design, & operating effectiveness of controls at the service	Planning: Obtaining an understanding of the user entity and its environment: as for Type 1 Reports. Responding to the assessed risks of	User Auditor: ASA 402 & ASA 330	Engagement letter: Appendix 1 Example 1 Service Organisation’s Description of its

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<b>Title of Report</b>	<b>Subject Matter Covered by Report</b>	<b>Circumstances for Which Report is Used by User Auditors</b>	<b>Relevant Standards</b>	<b>Appendix Reference for Examples</b>
	organisation.	material misstatement when evidence is required of the operating effectiveness of controls, over the services provided, at the service organisation.	Service Auditor: ASAE 3402	System and Assertion: Appendix 2; Minimum Control Objectives: Appendix 3; Service Auditor's Type 2 Report: Appendix 4 and Appendix 5
Service Auditor's Reports on financial information				
3. Service Auditor's Report on Specified Assertions	Specified assertions regarding balances or transactions of the user entity reported in a Statement.	Require evidence from procedures conducted at the service organisation regarding certain assertions with respect to balances or transactions of the user entity, reported in a Statement.	Service Auditor: ASA 805	Engagement letter: Appendix 1 Example 2 Service Auditor's Report: Appendix 6 Example 1
4. Service	Balances or	Require evidence from procedures	Service	Engagement letter:

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<b>Title of Report</b>	<b>Subject Matter Covered by Report</b>	<b>Circumstances for Which Report is Used by User Auditors</b>	<b>Relevant Standards</b>	<b>Appendix Reference for Examples</b>
Auditor's Report on a Statement	transactions of the user entity reported in a Statement.	conducted at the service organisation regarding the balances or transactions of the user entity, reported in a Statement.	Auditor: ASA 805	Appendix 1 Example 3 Service Auditor's Report: Appendix 6 Example 2

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references to appendices containing examples of each report and related engagement letters.

8. The guidance in this Guidance Statement is based on engagements to provide an opinion based on reasonable assurance, with respect to controls or financial information. It does not apply to an engagement to provide a review conclusion on controls based on limited assurance, however, it may be adapted, as necessary in the circumstances, to an engagement to provide limited assurance on specified assertions or a Statement. A review conclusion from the service auditor may be appropriate where the user auditor is engaged to perform a review of the user entity's financial report. The service auditor exercises professional judgement in applying this Guidance Statement to a review and, when reporting on specified assertions or a Statement, complies with the requirements of relevant standards on review engagements.
9. The user auditor may request the user entity to obtain a service auditor's report on agreed-upon procedures. Agreed-upon procedures engagements may be appropriate in certain circumstances to provide evidence that the user auditor requires, for example when:
- A type 2 report is provided, however the user auditor requires more evidence with respect to controls over a specified area, such as unit pricing.
  - Provision of service auditor reports is not agreed in the service level agreement or contract, but the user auditor nevertheless requires selected controls to be tested at the service organisation.
  - A Service Auditor's Report on Specified Assertions is provided as described in this Guidance Statement, however further audit procedures are required by the user auditor in obtaining sufficient appropriate audit evidence with respect to particular assertions. For example, with respect to the assertion of valuation, agreement of valuation input variables to source data may be required by the user auditor.

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Such engagements are conducted under Standards on Related Services<sup>10</sup> and no further guidance on agreed-upon procedures engagements is provided in this Guidance Statement.

**Services Relevant to this Guidance Statement**

10. This Guidance Statement has been developed specifically for circumstances where service organisations provide investment management services to user entities, where those services and the controls over them, are part of the user entity's information system<sup>11</sup>, including business processes, relevant to financial reporting, and as a result are relevant to the audit of a user entity's financial report. The Investment Management Services addressed in this guidance statement are:

- Custody.
- Asset Management
- Property Management.
- Superannuation Member Administration.
- Investment Administration.
- Registry.

Each of these services is defined in Appendix 4.

11. Although this Guidance Statement has been written in the context of the service organisation providing any of the investment management services specified in paragraph 10 user and service auditors may use this Guidance Statement, as appropriate, where the service organisation provides other services which are part of the user entity's information system relevant to financial reporting.

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<sup>10</sup> See ASRS 4400 Agreed-upon Procedures Engagements to Report Factual Findings.

<sup>11</sup> The circumstances under which a service organisation's services are part of a user entity's information system, including business processes, relevant to financial reporting, are provided in ASA 402 paragraph 3.

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12. Operators of investor directed portfolio services (IDPS)<sup>12</sup> and investor directed portfolio-like services are required by ASIC Class Order 02/294<sup>13</sup> and Class Order 02/296<sup>14</sup> to obtain an auditor's report providing an opinion on the internal controls and other relevant accounting procedures as they relate to the specific annual investor statements, and a review conclusion on the annual investor statements, quarterly reports in certain circumstances and information accessible to clients electronically. These class orders provide requirements for the form and content of the report in these circumstances. Reports provided under these class orders may provide sufficient appropriate audit evidence for a user auditor. If additional evidence is required by the user auditor, a service auditor's report on controls or on financial information may be requested. IDPS or IDPS-like services generally include custody and investment administration, consequently, if a type 1 or 2 report is provided the user auditor can reasonably expect the operator (service organisation) and service auditor of an IDPS to report on the control objectives for the relevant services provided in this guidance statement.
13. Types of service organisations which provide some or all of these investment management services include:
- Custodians.
  - Third Party Administrators.
  - Investment Managers.
  - Registrars.

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<sup>12</sup> "IDPS" means an investor directed portfolio service, consisting of a number of functions including a custody, settlement and reporting system and service. The clients of the service have the sole discretion to decide what assets will be acquired or disposed of. The service is provided in such a way that clients are led to expect, and are likely to receive, benefits in the form of access to investments that the client could not otherwise access directly or cost reductions by using assets contributed by the client or derived directly or indirectly from assets contributed by the client with assets contributed by other clients or derived directly or indirectly from assets contributed by other clients.

<sup>13</sup> See ASIC Class Order 02/294 *Investor Directed Portfolio Services*.

<sup>14</sup> See ASIC Class Order 02/296 *Investor Directed Portfolio-like Services provided through a registered managed investment Scheme*.

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- Trust Departments of Financial Institutions.
  - Prime Brokers.
14. The responsible parties which typically engage the services of these service organisations on behalf of user entities, include but are not limited to:
- Trustees for Superannuation Funds.
  - Responsible Entities for Registered Managed Investment Schemes.
  - Trustees for Unregistered Unit Trusts.
  - Boards of Insurance Companies.
15. The responsibilities of the responsible party of a user entity are set out in the relevant laws and regulations governing their role and the particular services they oversee.

**A: GUIDANCE FOR THE USER AUDITOR**

16. The use of a service organisation for the provision of investment management services by a user entity does not alter the overall objective of the audit of the user entity's financial report, therefore it remains the responsibility of the user auditor to obtain sufficient appropriate audit evidence to support the auditor's opinion. The requirements of the Auditing Standards relating to obtaining sufficient appropriate evidence on which to form an opinion are the same as would apply if the records and supporting documentation were maintained by the user entity.

**Obtaining an Understanding of the User Entity and its Environment**

17. In obtaining an understanding of the user entity and its environment under ASA 315, ASA 402 requires the user auditor to obtain an understanding of how the user entity uses the services of the service organisation in the user entity's operations, including:<sup>15</sup>
- (a) The nature of the services provided by the service organisation and the significance of those services to the user entity and the significance of services to the user entity;
  - (b) the nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
  - (c) the degree of interaction between the activities of the service organisation and those of the user entity; and
  - (d) the nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

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<sup>15</sup> See ASA 402, paragraph 9

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18. In obtaining this understanding, ASA 402<sup>16</sup> requires the user auditor to evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organisation and determine whether a sufficient understanding has been obtained to provide a basis for the identification and assessment of risks of material misstatement. In doing so the user auditor, considers the contract and/or service level agreement between the user entity and service organisation, along with information from other sources, such as user manuals, system overviews and technical manuals.

**Using a Type 1 Report**

19. In planning the audit of the user entity, the user auditor may be unable to obtain a sufficient understanding of the user entity and its environment in order to identify and assess the risks of material misstatement and to design further audit procedures, from the information available at the user entity regarding the services provided by the service organisation. In this case, ASA 402<sup>17</sup> requires the user auditor to perform one or more of the following procedures:
- (a) Obtain a type 1 or type 2 report, if available ;
  - (b) Contact the service organisation, through the user entity, to obtain specific information;
  - (c) Visit the service organisation and perform procedures that will provide the necessary information about the relevant controls at the service organisation; or
  - (d) Use another auditor to perform procedures that will provide the necessary information about the relevant controls at the service organisation.<sup>18</sup>

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<sup>16</sup> See ASA 402, paragraph 10-11.

<sup>17</sup> See ASA 402, paragraph 12.

<sup>18</sup> See ASA 402 paragraph 12

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20. In applying ASA 402, it may be more efficient for all parties concerned if the user auditor obtains a report on controls rather than visiting the service organisation. A Type 1 Report is sufficient for this purpose, however, if an appropriate Type 2 Report is already available, this also contains the information required.
21. ASA 402 requires the user auditor to satisfy themselves as to the professional competence and independence of the service auditor and the adequacy of the standards under which the report was issued.<sup>19</sup> The service organisation may provide reports on controls to user entities prepared under legislation or auditing standards applicable in another jurisdiction, to meet its statutory or other reporting requirements or under the service level agreement with user organisations in that jurisdiction. Reports on controls prepared under the reporting framework of another jurisdiction may also meet the needs of domestic user entities and user auditors where those reports include the equivalent evidence which would be contained in a Type 1 Report. The user auditor may obtain information about the standards used by the service auditor from the standard setting organisation.
22. In order to obtain a sufficient understanding of the user entity's internal control to plan the audit, the user auditor considers available reports on controls at the service organisation for an appropriate period or as at an appropriate date, along with information obtained at the user entity to understand:<sup>20</sup>
- (a) The aspects of the service organisation's controls that may affect the processing of the user entity's transactions, including the use of sub-service organisations;
  - (b) The flow of significant transactions through the service organisation to determine the points in the transaction flow where material misstatements in the user entity's financial report could occur;

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<sup>19</sup> See ASA 402 paragraph 13

<sup>20</sup> See ASA 402 paragraph 14 and A22.

- (c) The control objectives at the service organisation that are relevant to the user entity's financial report assertions; and
- (d) Whether controls at the service organisation are suitably designed and implemented to prevent or detect processing errors that could result in material misstatements in the user entity's financial report.

### **Assessing the Risks of Material Misstatement and Designing Further Audit Procedures**

23. Where the user auditor concludes that the investment management services provided by the service organisation are relevant to the audit, in that those services are part of the user entity's information system relevant to financial reporting, the user auditor, in order to identify and assess the risks of material misstatement and design further audit procedures, considers matters such as:

- The effectiveness of the user entity's monitoring controls over the investment management services provided by service organisations. The less effective the monitoring controls at the user entity, the greater the level of enquiry the user auditor undertakes in relation to the service organisation's controls.<sup>21</sup>
- The accuracy and timeliness of the reports and information received from the service organisation in previous periods. The user entity may rely on the financial information contained in the Statement from the service organisation in the preparation of their financial report. Past inaccuracies may increase the assessed risk of material misstatement with respect to particular assertions such as completeness, rights and obligations and valuation.
- The occurrence of significant deficiencies in the system of control of the service organisation or in the monitoring or complementary controls of the user entity in the past.

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<sup>21</sup> Examples of controls that might be established by the user entity over the service organisation's services, are provided in ASA 402 paragraph A12.

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- Information available regarding any changes in the service organisation's control systems since the date of the last audited information<sup>22</sup>.
  - Any changes in the contract or service level agreement between the user entity and the service organisation.
  - Information available which may impact the financial viability or reputation of the service organisation<sup>23</sup>.
  - Any history of disagreements between the user entity and the service organisation.
  - Any unexplained, unjustified or repeated delays in reporting by the service organisation.
  - Situations which may reflect on the service organisation's independence from the user entity.
24. If the user auditor concludes that the risk of material misstatement will not be affected by the controls at the service organisation under ASA 402 or that it is more appropriate to gather the evidence required by alternative procedures, which may include obtaining a Service Auditor's Report on a specified assertion or on a Statement, then a Type 1 or a Type 2 Report is not necessary. If there is a high degree of interaction between the activities of the service organisation and the user entity, the user auditor may be able to rely on monitoring controls at the user entity and not require evidence of the operating effectiveness of controls at the service organisation. Tests of monitoring controls could include testing the user entity's independent re-performance of selected items processed by the

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<sup>22</sup> Examples of procedures the user auditor may perform to update the information in a type 1 or type 2 report, are provided in ASA 402 paragraph A23. Relevant factors in determining what additional audit evidence to obtain about controls at the service organisation that were operating outside of the period covered by the service auditor's report, are provided in ASA 402 paragraph A33.

<sup>23</sup> Sources of information are listed in ASA 402 paragraphs A1 and A2.

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service organisation or testing the user entity's reconciliation of output reports with source documents.<sup>24</sup>

25. In assessing the risks of material misstatement and designing further audit procedures, the user auditor uses a Type 1 Report to:
- (a) determine whether the user auditor will seek to rely on certain controls to reduce the level of substantive procedures by obtaining evidence of the operating effectiveness of those controls; and
  - (b) determine whether complementary user entity controls identified by the service organisation are relevant to the user entity and, if so, obtain an understanding of whether those controls have been designed and implemented by the user entity.<sup>25</sup>
26. A Type 1 Report cannot be relied upon to reduce the level of substantive procedures conducted by the user auditor, as it does not provide any evidence of the operating effectiveness of those controls. Consequently, the usefulness of a Type 1 Report to a user auditor is limited to planning the audit, assessing the risk of material misstatement and designing further audit procedures.

**Responding to Assessed Risks of Material Misstatement**

27. Under ASA 402<sup>26</sup>, when responding to assessed risks, the user auditor :
- (a) Determines whether sufficient appropriate audit evidence concerning the relevant financial report assertions is available from records held at the user entity; and, if not,
  - (b) Performs further audit procedures to obtain sufficient appropriate audit evidence or uses another auditor to perform those procedures at the service organisation on the user auditor's behalf.

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<sup>24</sup> See ASA 402 paragraph A7.

<sup>25</sup> See ASA 402 paragraph 14(c).

<sup>26</sup> See ASA 402 paragraph 15

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28. When the user auditor's risk assessment includes an expectation that controls at the service organisation over the investment management services provided are operating effectively, ASA 402<sup>27</sup> requires audit evidence of the operating effectiveness of controls to be obtained by either:
- (a) Obtaining a Type 2 report, if available;
  - (b) Performing appropriate tests of controls at the service organisation; and/or
  - (c) Using another auditor to perform tests of controls at the service organisation on behalf of the user auditor.
29. Method (a) above, obtaining a Type 2 report, ordinarily is the most efficient method of gathering evidence of operating effectiveness of controls, where the service auditor conducts controls testing at the service organisation for use by multiple user auditors. Consequently, this Guidance Statement is based on the expectation of the provision of a Type 2 Report regarding investment management services provided to user entities.
30. Methods (b) and (c) ordinarily are not efficient for all parties involved, where a service organisation provides investment management services to numerous user entities, because it involves multiple user auditors or another auditor whom they have engaged individually visiting the service organisation.
- If reports on controls are prepared under legislation or auditing standards applicable in another jurisdiction, those reports may also meet the needs of domestic user entities and user auditors where those reports include the equivalent evidence which would be contained in a Type 2 Report. *Using a Type 2 Report*
31. A Type 2 Report comprises a Service Organisation's Description of its System and assertion on the description, design, and operating effectiveness of controls (Appendix 2), designed to meet control objectives (Appendix 3) for the investment management services

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<sup>27</sup> See ASA 402 paragraph 16

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provided to user entities, accompanied by a Service Auditor's Report thereon (Appendix 4). Other reports may be required by the user entity as set out in the contract and/or service level agreement for purposes such as monitoring the performance of the service organisation, however the reports covered by this Guidance Statement are limited to those that may be used by user auditors as audit evidence for the audit of the user entity's financial report.

32. In addition to using a Type 2 Report in planning the audit, assessing the risks of material misstatement and designing further audit procedures as described in paragraph 22 and 23, if the user auditor's risk assessment includes an expectation that relevant controls at the service organisation are operating effectively, then the Type 2 Report may provide audit evidence that the service organisation's controls are operating effectively for certain assertions regarding the user entity's balances or transactions.
33. If the user auditor plans to use a Type 2 report, under ASA 402<sup>28</sup>, the user auditor determines whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by: evaluating whether the date or period covered by the report is appropriate for the user auditor's purposes; determining whether relevant complementary user entity controls are designed, implemented and operating effectively; evaluating the time period covered by the tests of controls and whether those tests are relevant to the assertions in the user entity's financial report. :
34. When considering the sufficiency and appropriateness of the audit evidence in paragraph 33, the user auditor determines whether:
- (a) each of the control objectives specified in this Guidance Statement for the relevant investment management service/s have been addressed in the service organisation's description of its system and assertion;

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<sup>28</sup> See ASA 402 paragraph 17 and 18.

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- (b) the related controls identified have been reported on by the service auditor; and
  - (c) adequate justification has been provided by the service organisation for any control objectives for which no related controls are identified.
35. When the service organisation has used a subservice organisation in providing investment management services to the user entity and those services are excluded from the type 1 or 2 report, ASA 402 requires, if those services are relevant to the audit of the user entity, the user auditor to apply the requirements of ASA 402 with respect to the services of the subservice organisation.<sup>29</sup>
36. A Type 2 Report addresses the controls of the service organisation over the specified investment management service/s generally and not specifically the transactions or services relating to an individual user entity. Consequently, if the user auditor intends to use such a report, the user auditor considers the relevance of the stated control objectives and controls to the user entity and determines which additional procedures and/or assurance, if any, may be required in gathering sufficient appropriate audit evidence with respect to transactions and balances of the user entity related to the investment management services provided.<sup>30</sup>
37. A Type 2 Report, containing an unmodified opinion, ordinarily provides the user auditor with sufficient appropriate audit evidence as to the reliability of controls over the investment management services provided by the service organisation to the user entity and accordingly may enable the user auditor to reduce the extent of substantive testing that might otherwise have been necessary with respect to the balances or transactions subject to those services.
38. A Type 2 Report does not eliminate the need for substantive procedures altogether, as ASA 330 requires the auditor, irrespective of the assessed risk of material misstatement, to design and perform

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<sup>29</sup> See ASA 402 paragraph 18.

<sup>30</sup> See ASA 402 paragraph A31 for further application material on factors to consider in evaluating the sufficiency and appropriateness of the audit evidence provided by the service auditor's report.

substantive procedures for each material class of transactions, account balance and disclosure.

### **Reports on Controls Issued on a Different Reporting Date to the User Entity's Financial Report**

39. The reporting date or reporting period of the user entity may differ from the date or period for which the service organisation issues a Type 1 or 2 Report, in which case ASA 420<sup>31</sup> requires that the user auditor evaluate whether that date or period is appropriate for the user auditor's purposes. It may still assist the user auditor in obtaining a preliminary understanding of the controls implemented at the service organisation if the report is supplemented by additional current information from other sources. The longer the interval between the last date for which a report on controls is available and the reporting date of the user entity ("the interval"), the less assurance the report on controls provides. Where the reporting dates differ, the user auditor considers which procedures are necessary to obtain sufficient appropriate audit evidence regarding the design and implementation of the service organisation's controls at the user entity's reporting date and, if required, operating effectiveness of those controls over the interval.<sup>32</sup>
40. In determining the additional audit evidence to obtain about controls at the service organisation operating outside of the period covered by the service auditor's report, the user auditor considers:<sup>33</sup>
- (a) The significance of the assessed risks of material misstatement at the assertion level;
  - (b) The specific controls that were tested during the interim period, and significant changes to them since they were tested, including changes in the information system, processes, and personnel;

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<sup>31</sup> See ASA 402, paragraph 17(a).

<sup>32</sup> See ASA 402, paragraphs A32-A35.

<sup>33</sup> See ASA 402, paragraph A33.

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- (c) The degree to which audit evidence about the operating effectiveness of those controls was obtained;
  - (d) The length of the remaining period;
  - (e) The extent to which the user auditor intends to reduce further substantive procedures based on the reliance of controls; and
  - (f) The effectiveness of the control environment and monitoring of controls at the user entity.
41. The user auditor considers the assessed risks of material misstatement relating to the services provided by the service organisation and exercises professional judgement in determining the extent of additional procedures required to obtain sufficient appropriate audit evidence. Examples of the type of procedures which the user auditor might conduct for different length intervals are detailed in paragraphs 42 to 46, however the user auditor adjusts these procedures depending on the assessed risks.
42. For a Type 1 or 2 Report that is for a date or for a period that is outside of the reporting period of a user entity, the user auditor may supplement the preliminary understanding of the controls by additional current information from other sources. The user auditor may perform procedures such as:
- Discussing the changes at the service organisation with user entity personnel who would be in a position to know of such changes;
  - Reviewing current documentation and correspondence issued by the service organisation; or
  - Discussing the changes with service organisation personnel.
43. If the user auditor determines that there have been changes in the service organisation's controls in the interval which may be significant to the user entity's audit, the user auditor seeks to gain an understanding of the changes and considers the effect of those

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changes on the assessed risks of material misstatement and on the design of further audit procedures.

44. For a Type 2 Report on design, implementation and operating effectiveness of controls, where the interval is short, such as a period of up to three months, the user auditor may conduct the procedures listed in paragraph 42 to identify any changes in the controls described in the Type 2 Report. In addition, the user auditor may seek a written representation from the service organisation regarding the continued operating effectiveness of controls identified in the Type 2 Report and the operating effectiveness of any new controls implemented during the interval, particularly those relevant to the user entity's audit. Further tests of the operating effectiveness of those controls may be necessary where the changes implemented are significant to the audit of the user entity<sup>34</sup>.
45. For a longer interval, such as in excess of three months, up to and including six months, in addition to conducting the procedures in paragraph 44, the user auditor may request the user entity to obtain evidence from the service organisation that the controls are still in place and that any new controls are operating effectively. This may take the form of a service auditor's review or an agreed-upon procedures engagement.
46. For a long interval, such as in excess of six months, the user auditor considers the sufficiency and appropriateness of the available audit evidence and, where further evidence is required, the user auditor:
- Conducts alternative audit procedures.
  - Requests that the user entity to obtain a new Type 2 Report under this Guidance Statement from the service organisation.
  - Visits the service organisation to gather the evidence required.

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<sup>34</sup> Additional guidance on further procedures that can be carried out to obtain additional audit evidence, are provided in ASA 402 paragraphs A34 to A37.

If sufficient appropriate audit evidence is not available from any of these sources, the user auditor considers whether modifications to the user auditor's report are necessary.

### **Assessing Deviations Reported or a Modified Opinion on Controls**

47. Type 1 and 2 Reports are prepared for the purposes of multiple user entities, not specifically for the purposes of any individual user auditor. Deviations noted by the service auditor or a modified opinion in the Service Auditor's Report do not imply that the Service Auditor's Report is not useful for the audit of the user entity's financial report. Rather, the deviations and the matters giving rise to a modified opinion in the Service Auditor's Report are considered in the user auditor's assessment of the results of the testing of controls performed by the service auditor.<sup>35</sup>
48. The user auditor makes the user auditor's own assessment of the materiality, in relation to the user entity, of the control deviations identified in the Service Auditor's Type 1 or 2 Report in determining whether those deviations amount to significant deficiencies to be reported to those charged with governance as described in paragraph 62 and in deciding on an appropriate response.<sup>36</sup>

### **Using a Service Auditor's Report on Financial Information**

49. Whilst the user auditor may be able to rely on a Type 2 Report as audit evidence of the operating effectiveness of controls to mitigate identified risks of material misstatement, a Type 2 Report alone cannot provide sufficient appropriate audit evidence with respect to material balances or classes of transactions of the user entity. ASA 330<sup>37</sup> requires the user auditor to design and perform substantive procedures for each material class of transactions, account balance and disclosure. The manner in which substantive

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<sup>35</sup> See ASA 402 paragraph A38.

<sup>36</sup> See ASA 402 paragraph A38.

<sup>37</sup> See ASA 330 paragraph 18.

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procedures may be conducted is discussed in paragraphs 50 and 51.<sup>38</sup>

50. Service organisations which provide investment management services may provide the user entity with a single financial statement regarding financial information of the user entity (“Statement”) periodically in accordance with either a general purpose framework<sup>39</sup> or special purpose framework<sup>40</sup>. Examples of a Statement include: a portfolio valuation report, a financial report or a component of a financial report. The requirements of the applicable financial reporting framework determine the form and content of the Statement. An un-audited Statement is an unverified source of evidence, which is a representation not independent from the user entity. If the financial report of the user entity has been prepared using un-audited financial information obtained from the service organisation, such information may not constitute sufficient appropriate audit evidence on which the user auditor could form an opinion.
51. The user auditor’s procedures at the user entity with respect to the balances and transactions relating to the services provided by the service organisation may be limited to:
- A review of the contract or service level agreement between the user entity and the service organisation so as to understand the rights and obligations of each party.
  - A review and evaluation of the monitoring controls exercised by the user entity over the service organisation.
  - A review of representations given by the service organisation concerning the user entity’s balances or transactions.

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<sup>38</sup> See ASA 402, paragraphs A27 and A28 for further application material on conducting substantive procedures at a service organisation.

<sup>39</sup> See ASA 700, paragraph 7(b) for definition of general purpose framework.

<sup>40</sup> See ASA 800, paragraph 6(b) for definition of special purpose framework.

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- Verification of the receipt of income from the service organisation (if not re-invested).
- Analytical procedures on the financial information supplied by the service organisation.
- A review of the most recent audited financial report of the service organisation.

Procedures conducted at the user entity alone, or even in combination with a Type 1 or 2 Report on the relevant investment management services, may not generate sufficient appropriate audit evidence.

52. The user auditor exercises professional judgement to determine whether procedures conducted at the user entity as described in paragraph 47, considered alone or in combination with a Type 1 or 2 Report, provide sufficient, appropriate evidence on which to form an audit opinion. If the user auditor requires further audit evidence, which the user auditor believes to be held at the service organisation, the user auditor either:
- (a) obtains a Service Auditor's Report on financial information; or
  - (b) gains access to the records and other information relating to the user entity in the possession of the service organisation.
53. As with the Type 1 or 2 Report, it may be more efficient, for all parties concerned, if the user auditor can obtain the audit evidence required from the service auditor. Individual circumstances determine whether a Service Auditor's Report on financial information is the more effective or efficient method of obtaining the audit evidence required by the user auditor. If the user auditor is able to specify whether the service auditor prepares a Service Auditor's Report on specified assertion or on a Statement, the user auditor must exercise professional judgement to make this determination in the particular circumstances of the engagement.

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54. A Service Auditor's Report on a Statement, as defined in paragraph 4(b)ii, may be the most effective way to obtain sufficient appropriate audit evidence for all assertions regarding the user entity's balances or transactions contained in the Statement provided by the service organisation. This type of report may also be required by the user auditor if there is a potential or identified significant deficiency in the service organisation's controls, or there are material errors identified in the service organisation's reports.
55. The user auditor may be able to obtain sufficient appropriate audit evidence only for certain assertions relating to the user entity's balances or transactions contained in the Statement from information available from the user entity's records and from audit procedures performed thereon by the user auditor. For the remaining assertions, a Service Auditor's Report on Specified Assertions, as defined in paragraph 4(b)(i), may be the most efficient and effective way of obtaining the audit evidence required. This may include any of the assertions identified in ASA 315<sup>41</sup>, which are:
- (a) for classes of transactions and events for the period under audit: occurrence, completeness, accuracy, cut-off and classification;
  - (b) for account balances at the period end: existence, rights and obligations, completeness, valuation and allocation; and
  - (c) for presentation and disclosure: occurrence and rights and obligations, completeness, classification and understandability and accuracy and valuation.

In many circumstances, the use of a Service Auditor's Report on Specified Assertions in conjunction with a Type 2 Report provide the user auditor with sufficient appropriate audit evidence concerning the balances or transactions reported in the Statement.

56. In evaluating the audit evidence provided by a Service Auditor's Report on financial information, the user auditor considers:

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<sup>41</sup> See ASA 315 *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph A111.

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- (a) the professional competence of the service auditor in the context of the assignment conducted;
- (b) the sufficiency and appropriateness of the evidence, whether on its own or in conjunction with a Type 1 or 2 Report, provided by the Service Auditor's report on financial information regarding the assertions on which evidence is required;
- (c) the impact of any modification to the Service Auditor's Report on financial information on the sufficiency and appropriateness of the evidence provided by the report;
- (d) the effect of any uncorrected misstatements reported by the service auditor in an attachment to their report, as described in paragraph 138; and
- (e) the effect of any other matters, including significant deficiencies in internal control, significant findings from the audit or fraud, identified during the audit or reported by the service organisation to the user entity.

**Materiality for Service Auditor's Reports on Financial Information**

57. Paragraphs 138 to 139 of this Guidance Statement provide an appropriate basis for the service auditor to determine materiality for auditing specified assertions or a Statement. The user auditor, in determining performance materiality under Auditing Standard ASA 320<sup>42</sup> for the classes of transactions, account balances or disclosures effected by the services of the service organisation, may determine that the performance materiality level which would be determined by the service auditor in applying this Guidance Statement is not suitable for the purposes of the audit of the user entity's financial report. In these circumstances, the user auditor may request that an alternative benchmark and/or percentage is used by the service auditor to determine performance materiality. The

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<sup>42</sup> ASA 330 *Materiality in Planning and Performing an Audit*, paragraphs 11 & A12.

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manner in which such a request is ordinarily communicated is discussed in paragraphs 60 and 61.

58. The user auditor makes the user auditor's own assessment of the materiality of any uncorrected misstatements communicated by the service auditor in the attachment, if any, to the Service Auditor's Report on financial information provided as described in paragraph 136, with respect to the audit of the user entity's financial report.

**Communicating with the Service Auditor**

59. Ordinarily, the user auditor does not communicate directly with the service auditor, communication is through the user entity and service organisation. The user auditor communicates requirements with respect to the service auditor's work as early as possible to the user entity. These requirements are then communicated by the user entity to the service organisation, either under the terms of a contract or service level agreement<sup>43</sup> or by means of a specific request. In turn, these requirements are communicated by the service organisation to the service auditor and key requirements ordinarily are reflected in the service auditor's engagement letter with the service organisation.
60. The user auditor's engagement letter may contain requirements for the user entity to obtain from the service organisation, where possible, Type 1 or 2 Reports or Service Auditor's Reports on financial information.

**Communicating With Those Charged With Governance of the User Entity**

61. The user auditor is required under the Auditing Standards to communicate any of the following matters identified to those charged with governance of the user entity on a timely basis:
- (a) significant deficiencies in internal control identified during the audit;<sup>44</sup>

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<sup>43</sup> See ASA 402 paragraph A8.

<sup>44</sup> See ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9.

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- (b) significant findings from the audit<sup>45</sup>;
- (c) uncorrected misstatements and the effect they, individually or in aggregate, may have on the opinion in the auditor's report<sup>46</sup>; and
- (d) fraud, identified or suspected involving management, employees who have significant roles in internal control or others where the fraud results in a material misstatement, as well as any other matters related to fraud that are relevant to their responsibilities.<sup>47</sup>

62. In determining whether there are any matters which the user auditor needs to report to those charged with governance of the user entity, as outlined in paragraph 62, with respect to the investment management services provided by the service organisation, the user auditor's procedures may include:

- A review of documentation and correspondence at the user entity regarding oversight and monitoring of the performance of the contract and/or service level agreement by the service organisation.
- Enquiries of those charged with governance, management or others within the user entity regarding whether any of the matters listed in paragraph 62 have been reported by the service organisation to the user entity.
- Identification of any exceptions reported by the service auditor in the Type 1 or 2 Report and evaluation of whether those exceptions represent significant deficiencies in the user entity's internal control.
- Enquiries regarding the reasons for any modification to the Service Auditor's Type 1 or 2 Report or report on financial information.

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<sup>45</sup> See ASA 260 *Communication with Those Charged with Governance*, paragraph 16.

<sup>46</sup> See ASA 450 *Evaluation of Misstatements Identified during the Audit*, paragraph 12.

<sup>47</sup> See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraph 41 and 42.

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- Identification of any uncorrected misstatements reported by the service auditor, in an attachment to the Service Auditor's Report on financial information as described in paragraph 136 of this Guidance Statement.
63. ASA 402<sup>48</sup> requires the user auditor to enquire of management of the user entity whether the service organisation has reported to the user entity, or the user entity is aware of, any fraud, non-compliance with laws and regulations or uncorrected misstatements affecting the financial report of the user entity. These matters of governance interest may have been communicated by the service auditor to the service organisation as described in paragraphs 119 or 137. In addition, a service organisation may be required under the contract or service level agreement with the user entity to disclose matters including those listed in paragraph 59 that may affect the user entity. The user auditor evaluates the effect of any matters reported on the nature, timing and extent of further audit procedures.<sup>49</sup>
64. Where the user auditor does not have sufficient information regarding the matters of governance interest to fulfil the user auditor's responsibility as outlined in paragraph 59, the user auditor may request further information to be provided. Whilst this information may be provided by the service auditor, the request is ordinarily made through the user entity.

**Reporting by the User Auditor**

65. If the user auditor concludes that the user entity's financial report contains material misstatements with respect to the services provide by the service organisation or that the user auditor is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit to form an opinion, ASA 705 requires the user auditor to modify their opinion on the user entity's financial report.<sup>50</sup>

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<sup>48</sup> See ASA 402, paragraph 19.

<sup>49</sup> See ASA 402, paragraph A41.

<sup>50</sup> See ASA 705, paragraph 6 and ASA 402, paragraph 20.

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66. In accordance with ASA 402<sup>51</sup> and the Auditing Standards, the user auditor does not refer to the work of a service auditor in the user auditor's report, unless required to do so by law or regulation or if it is relevant to understanding a modification to the user auditor's opinion.

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<sup>51</sup> See ASA 402 paragraph 21 and 22.

## **B: GUIDANCE FOR THE SERVICE AUDITOR**

### **Types of Engagements**

67. Under a contract or service level agreement, the service organisation may agree to provide periodically the user entity with a Type 1 or 2 Report on controls with respect to the services provided to the user entity and/or a Statement, with respect to the user entity's assets, liabilities or transactions recorded by the service organisation for the period, accompanied by a Service Auditor's Report on the Statement or specified assertions.

### **Engagements to Report on Controls**

#### *Nature of Engagement*

68. Service auditors' engagements to provide Type 1 or 2 Reports on controls are assurance engagements, which are defined under the *Framework for Assurance Engagements* as engagements in which the auditor expresses a conclusion or opinion about the outcome of the evaluation of a subject matter against criteria. The service auditor evaluates the controls at the service organisation over the investment management services provided to user entities (the subject matter), expressed in the service organisation's description of its system (subject matter information), against control objectives (criteria). The service auditor applies the requirements and considers the application material in ASAE 3402 when conducting assurance engagements on controls at a service organisation.
69. The control objectives collectively reflect the level of control over user entities' balances or transactions that the user entity could reasonably expect from the service organisation for the purpose of the user entity's financial reporting. The service organisation's controls are designed to meet those control objectives. Appendix 3 sets out the control objectives which the user entity can expect to be included in Type 1 or 2 Reports for each of the relevant investment management services. The service organisation may choose to include additional control objectives in the Type 1 or 2 Report. Additional control objectives may be included where those

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objectives are relevant to user entities' financial reporting or to meet compliance reporting requirements or the terms of the service level agreement or contract.

*Acceptance and Continuance of Engagements to Report on Controls*

70. The scope and purpose of the engagement between the service auditor and the service organisation needs to be clearly understood and agreed. In meeting the requirements of ASAE 3402<sup>52</sup>, before agreeing to accept, or continue an engagement, the service auditor:
- (a) Determines whether:
    - (i) The service auditor has the capabilities and competence with respect to the relevant investment management services to perform the engagement;
    - (ii) The criteria, including the investment management services control objectives, to be applied by the service organisation to prepare the description of its system will be suitable and available to user entities and their auditors; and
    - (iii) The scope of the engagement and the service organisation's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors, such as exclusion of aspects of the service offering.
  - (b) Obtains the agreement of the service organisation that it acknowledges and understands its responsibility:
    - (i) For the preparation of the description of its system, and accompanying service organisation's assertion, including the completeness, accuracy and method of presentation of that description and assertion;

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<sup>52</sup> See ASAE 3402, paragraph 13.

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- (ii) To have a reasonable basis for the service organisation's assertion accompanying the description of its system;
- (iii) For stating in the service organisation's assertion the criteria it used to prepare the description of its system;
- (iv) For stating in the description of its system the control objectives, including the minimum controls objectives provided in this guidance statement for the investment management services are provided by the service organisation
- (v) For identifying the risks that threaten achievement of the control objectives stated in the description of its system, and designing and implementing controls to provide reasonable assurance that those risks will not prevent achievement of the control objectives stated in the description of its system, and therefore that the stated control objectives will be achieved; and
- (vi) To provide the service auditor with:
  - a. Access to all information, such as records, documentation and other matters, including service level agreements, of which the service organisation is aware that is relevant to the description of the service organisation's system and the accompanying service organisation's assertion;
  - b. Additional information that the service auditor may request from the service organisation for the purpose of the assurance engagement; and

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- c. Unrestricted access to persons within the service organisation from whom the service auditor determines it necessary to obtain evidence.
71. This understanding and agreement is identified in the terms of engagement, set out in an engagement letter, or some other form of written communication, which include:
- (a) the objective and scope of the work to be performed by the service auditor;
  - (b) the service auditor's responsibilities to:
    - (i) conduct the engagement in accordance with Standards on Assurance Engagements and with reference to this Guidance Statement,
    - (ii) conduct tests and enquiries to form an opinion on the design, implementation and, for Type 2 Reports, operating effectiveness of the controls contained in the Service Organisation's Description of the System either as at period end (for Type 1 Reports) or for the period (for Type 2 Reports), and
    - (iii) provide a written report on the design, implementation and, for Type 2 Reports, operating effectiveness of the controls identified in the Service Organisation's Description of the System either as at period end (for Type 1 Reports) or throughout the period (for Type 2 Reports);
  - (c) management's, or those charged with governance's, acknowledgement of their responsibility for the matters identified in paragraph 75(b);
  - (d) the agreed use of the report and the extent to which, the context in which, and the basis on which, the report may be

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made available by the service organisation to user entities and user auditors;

- (e) an explanation of the inherent limitations of the work, and for whom the work is being undertaken;
- (f) an overview of the assurance approach and assurance procedures which are to be encompassed by the service auditor's work; and
- (g) a reference to the likely need for management representations.

An example of an engagement letter for engagements to report on controls is shown at Appendix 1 Example 1.

*Ethical Requirements*

- 72. The service auditor only accepts an engagement to report on controls when the service auditor is satisfied that relevant ethical requirements, including those pertaining to independence, relating to assurance engagements,<sup>53</sup> are met as required by ASAE 3402.<sup>54</sup> This includes ensuring that the engagement team meets the applicable independence requirements.
- 73. In order to meet these independence requirements, the service auditor assesses likely threats to independence and, where necessary, applies safeguards.
- 74. Since the service auditor is engaged to report on the controls over the investment management services provided by the service organisation generally and not specifically in relation to any individual user entity, independence requirements do not necessarily extend to each user entity. Ordinarily it is sufficient for the service auditor to meet independence requirements with respect to the service organisation when engaged to report on controls over investment management services at the service organisation.

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<sup>53</sup> See ASA 102 *Compliance with Ethical Requirements when performing Audits, Reviews and Other Assurance Engagements*.

<sup>54</sup> See ASAE 3402, paragraph 11.

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However, threats to independence may arise with respect to user entities where there are only one or few user entities for the services subject to audit or subservice organisations where the controls of the subservice organisation are included in the Service Organisation's description of its system, under the inclusive method described in paragraph 83.

75. Service auditors may also need to consider the manner in which their Type 1 or 2 Report is used and distributed by the service organisation. Examples of how this matter may be addressed in the engagement letter and in the Service Auditor's Type 2 Report are contained in Appendix 1 Example 1 and Appendix 4 respectively.

*Responsibilities of the Service Organisation*

76. It is for management, or, where appropriate, those charged with governance, of the service organisation to decide whether to prepare a report on controls and whether to have this report audited by a service auditor. In certain circumstances, the service organisation may, for example, consider it more appropriate to allow access for user entities and user auditors to the service organisation's records or provide a report on a specific aspect of its operations as this impacts an individual user entity. However, this Guidance Statement is only applicable to circumstances where management, or those charged with governance, of the service organisation prepares a description of its system, for example in a manner consistent with the reporting format illustrated in Appendix 2, and the service auditor is engaged to provide an opinion thereon, as illustrated in Appendix 4.
77. The service organisation typically prepares a description of its system to meet the needs of all user entities of a particular investment management service or services. The Service Auditor's Type 1 or 2 Report covers investment management services provided to user entities which are likely to form part of those user entities' information systems relevant to financial reporting. The value of a Type 1 Report to the audit of the user entity is limited, so it is appropriate for the service auditor to prepare a Type 1 Report only in the first year of reporting on controls, to provide a starting point for future reports, or if none of the user entities require a report

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on the operating effectiveness of controls. Circumstances in which the user auditor may require a report only on design and implementation of controls are set out in paragraph 20. Since these circumstances are limited, an example of this report is not provided in this Guidance Statement.

78. The frequency with which the service organisation provides a report on controls may be agreed in the contract and/or service level agreement between the user entity and the service organisation.
79. In relation to an engagement to report on controls as described in this Guidance Statement, the service auditor can reasonably expect management, or those charged with governance, of the service organisation to be responsible for:
- (a) provision of investment management services to user entities;
  - (b) identification of the control objectives relevant to the financial reporting of clients to whom investment management services are provided by the service organisation;
  - (c) the design and operating effectiveness of controls at the service organisation that provide reasonable assurance that those control objectives will be achieved;
  - (d) evaluation of the accuracy of the description, suitability of the design (and for Type 2 Reports: operating effectiveness) of the service organisation's controls for the relevant period; and
  - (e) provision of a written report as described in paragraph 76.

*Assessing the Suitability of the Criteria*

80. In assessing whether the service organisation has used suitable criteria in preparing the description of the system, evaluating whether controls are suitably designed and, in the case of Type 2 reports, in evaluating whether controls are operating effectively, in

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accordance with ASAE 3402,<sup>55</sup> the service auditor determines whether the minimum control objectives provided in this guidance statement<sup>56</sup> for the relevant investment management service or services are included in the description of the system.

81. It is the responsibility of the service organisation to ensure that the control objectives are sufficient to meet the expectations of user entities and that any omissions or amendments to the minimum control objectives are appropriate. A service organisation may therefore consider the need to add further objectives and supporting controls where appropriate. The service auditor evaluates the suitability of any additional control objectives specified by the service organisation, by determining if they meet the characteristics of relevance, completeness, reliability, neutrality and understandability.<sup>57</sup>
82. If the service organisation omits or modifies a control objective from GS 007 or adds further control objectives, the service auditor can expect those omissions, modifications or additional objectives to be clearly identified in the service organisation's description of the system. If a control objective is omitted, the service organisation may list that objective and note briefly the reasons for its omission. If a control objective is modified to clarify the intended meaning, such as use of terms appropriate to the service organisation's circumstances, or the control objective is expanded, the relevant GS 007 control objective may be treated as included. However, if the meaning of the control objective is changed or the scope of the objective reduced by the modifications, then it is appropriate for the service organisation to report the relevant GS 007 objective as omitted and report the modified objective as an additional objective in the description of the system.

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<sup>55</sup> See ASAE 3402, paragraphs 15-18 for further requirements in assessing the suitability of the criteria.

<sup>56</sup> See Appendix 3.

<sup>57</sup> See ASAE 3000, paragraph 35-36.

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*Management's Report on the Service Organisation's Controls*

83. Typically, under the contract or service level agreement the service organisation agrees to provide user entities with a Type 1 or 2 Report, in accordance with ASAE 3402. An example of a Service Organisation's description of its system is shown at Appendix 2.
84. The service organisation is responsible for the completeness, accuracy, validity and method of presentation of the description of control objectives and controls. The description of controls includes controls that may be relevant to user entities. The service auditor may assist the service organisation in preparing the description; however, the representations in the description are the responsibility of management, or those charged with governance, of the service organisation.
85. The description of control objectives and controls does not necessarily address every service provided by the service organisation. The description presents a level of detail that may provide sufficient information for the user auditor to assess the risk of material misstatement and to design further audit procedures in response to the assessed risk and, in the case of Type 2 Reports, to assess the operating effectiveness of the controls as if a service organisation were not used. However, the description of controls need not be so detailed as to enable compromise of security or other controls.

*Complementary User Entity Controls*

86. The service organisation may design the system with the assumption that user entities implement certain complementary controls in order to achieve the specified control objectives. If this is the case, the description of the controls at the service organisation refers to such complementary internal controls of user entities ("complementary controls").
87. Complementary controls at the user entity may include general controls, such as the authorisation of transactions, the written notification of changes, the timely review of reports provided by the

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service organisation or appropriate restrictions on access to on-line terminals.

*Service Organisations That Use Subservice Organisations*

88. When a service organisation uses another service organisation (“subservice organisation”) to perform certain aspects of the services provided to user entities, the service organisation includes a description of the functions and nature of the processing performed by the subservice organisation in the service organisation’s description of its system. The description provides sufficient detail for the user entity and the user auditor to understand the significance of the subservice organisation’s operations to the processing of the user entity’s transactions.
89. If the subservice organisation’s controls are included in the service organisation’s description and in the scope of the service auditor’s engagement (“the inclusive method”),<sup>58</sup> then the subservice organisation’s controls are clearly differentiated from the controls of the service organisation. Under the inclusive method, the control objectives addressed in the report include all of the control objectives which both the service organisation and the subservice organisation are expected to achieve. To accomplish this, the service organisation co-ordinates the preparation and presentation of the description of controls with the subservice organisation.
90. If the subservice organisation’s controls are excluded from the service organisation’s description and from the scope of the service auditor’s engagement (“the carve-out method”),<sup>59</sup> the service organisation states in the description that the subservice organisation’s control objectives and allied controls are omitted from the description and that the control objectives in the Type 1 or 2 Report include only the objectives which the service organisation’s controls are intended to achieve. Where the carve-out method is used, the subservice organisation may issue a Type 1 or 2 Report to

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<sup>58</sup> Refer to ASAE 3402, paragraph 9(g).

<sup>59</sup> See ASAE 3402, paragraph 9(a).

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the service organisation which may then be relied upon by the user auditor.

*Service Auditor's Procedures*

91. In reporting on the service organisation's report on controls, the service auditor seeks to obtain sufficient appropriate evidence regarding whether, in all material respects:
- (a) the service organisation's description of the system fairly presents the system as designed and implemented as at a specified date (in the case of a Type 1 Report) or throughout the specified period (in the case of a Type 2 Report);
  - (b) the controls were suitably designed as at a specified date or throughout the specified period to to achieve their stated objectives; and
  - (c) the controls operated effectively to provide reasonable assurance that the control objectives stated in the service organisation's description of its system were achieved throughout the specified period, for Type 2 Reports.

*Planning*

92. Where Type 1 or 2 Reports are prepared in accordance with ASAE 3402, the service auditor's work is planned so as to have a reasonable expectation of detecting significant deficiencies in the controls described by the service organisation, and tested in accordance with the terms of the engagement. However, the nature, timing and extent of testing need not be designed with the expectation of detecting deficiencies which may be considered significant from the point of view of a particular user entity and, therefore, the scope of the work may mean that not all controls relevant to an individual user entity are tested by the service auditor.
93. In order to gain an understanding of the services provided by the service organisation, the service auditor may conduct procedures such as:

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- Discussing aspects of the control framework and relevant controls with management and other personnel of the service organisation.

*Determining the predominant types of user entities and the nature of the services provided by the service organisation to those user entities.*

*Written Representations*

94. The service auditor is required under ASAE 3402<sup>60</sup> to request the service organisation to provide written representations:
- (a) That reaffirm the assertion accompanying the description of the system;
  - (b) That it has provided the service auditor with all relevant information and access agreed to; and
  - (c) that it has disclosed to the service auditor any of the following of which it is aware, including:
    - (i) Non-compliance with laws and regulation, fraud or uncorrected deviations attributable to the service organisation that may affect one or more user entities;
    - (ii) Design deficiencies in controls, including those for which management believes the cost of corrective action may exceed the benefits;
    - (iii) Instances where controls have not operated as described,; and
    - (iv) Subsequent events which are likely to have a significant effect on the service auditor's assurance report.

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<sup>60</sup> See ASAE 3402 paragraph 38.

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95. Written representation is required<sup>61</sup> to be in the form of a representation letter addressed to the service auditor, ordinarily issued at the same date as the Service Organisation's description of its system and assertion or as near as practicable to, but not after the date of the service auditor's assurance report.

*Obtaining an Understanding of the Service Organisation's System*

96. ASAE 3402<sup>62</sup> requires the service auditor to obtain an understanding of the service organisation's system, including controls that are included in the scope of the engagement. In doing so, the service auditor identifies the boundaries of that system and ensures that the boundary of the investment management services included in the description of the system does not omit aspects of the services provided which are part of user entities' information system relevant to financial reporting. The description of each investment management services provided in this guidance statement is indicative and not definitive. The service organisation may provide multiple investment management services, in which case the service auditor identifies how the services interface.

*Obtain Evidence Regarding the Description of the System*

97. The service auditor obtains and reads the service organisation's description of its system and evaluates whether those aspects of the description included in the scope of the engagement are fairly presented, in accordance with ASAE 3402,<sup>63</sup> including whether control objectives are reasonable, controls identified in that description were implemented, complementary user entity controls are adequately described and services performed by a sub-service organisation, if any, are adequately described. In doing so, the service auditor determines whether the description is likely to provide sufficient information for user entities to obtain an understanding of those aspects of the service organisation's controls

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<sup>61</sup> See ASAE 3402, paragraph 39.

<sup>62</sup> See ASAE 3420, paragraph 20.

<sup>63</sup> See ASAE 3402, paragraph 21.

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that could reasonably be expected to be relevant to user entities' internal controls as they relate to financial reporting.

98. The service auditor is required<sup>64</sup> to conduct enquiries and other procedures to assess whether the service organisation's system has been implemented, including:

- Observing the procedures performed by the service organisation's personnel, which may also include "walk-through" tests of selected transactions and control procedures..
- Inspecting the service organisation's records and documentation, such as policy and procedure manuals, system flowcharts and narratives.

99. In assessing the reasonableness of the control objectives, the service auditor determines whether the control objectives for the relevant investment management service/s contained in Appendix 3 have been included or, for any objectives which have been excluded, the adequacy of the reasons why those objectives are not relevant. If there are any unjustified omissions or misstatements with regard to the control objectives, the service auditor asks management, or those charged with governance, to amend the description. If it is not amended, the service auditor considers the reasons, if known, for the omission or misstatement and the effect on the Service Auditor's Type 1 or 2 Report.

*Obtaining Evidence Regarding Design of Controls*

100. ASAE 3402<sup>65</sup> requires the service auditor to determine which of the controls at the service organisation are necessary to achieve the control objectives stated in the service organisation's description of its system and assesses whether those controls are suitably designed, by identifying the risks that threaten the achievement of the control

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<sup>64</sup> See ASAE 3402, paragraph 22.

<sup>65</sup> See ASAE 3402, paragraph 23.

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objectives, and evaluating the linkage of controls identified with those risks.

101. A control is designed suitably if individually, or in combination with other controls, it is likely to prevent or detect fraud or errors that could result in the non-achievement of specified control objectives when the described controls are operating effectively. The service auditor may use flowcharts, questionnaires, decision tables, documents and reports, as well as make enquiries of appropriate service organisation personnel and observation of the application of specific controls, to determine whether they are suitably designed to achieve the specified control objectives and if they are operated as prescribed, by appropriately qualified or experienced persons.

*Obtaining Evidence Regarding Operating Effectiveness of Controls*

102. When providing a Type 2 Report, the service auditor tests controls that the service auditor has determined are necessary to achieve the control objectives stated in the service organisation's description of its system and assess their operating effectiveness throughout the period in accordance with ASAE 3402.<sup>66</sup> Evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period.
103. The service auditor designs the nature, timing and extent of tests of operating effectiveness with the objective of determining whether and how a control procedure is applied, the consistency with which it is applied, by whom it is applied and how exceptions identified by operation of the control are addressed. If controls to be tested depend upon other controls (indirect controls), it may be necessary for the service auditor to obtain evidence supporting the operating effectiveness of those indirect controls. In selecting items for testing, the service auditor determined means which are effective in meeting the objectives of the procedure.<sup>67</sup>

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<sup>66</sup> See ASAE 3402, paragraph 24.

<sup>67</sup> See ASAE 3402, paragraph 25.

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104. Where the service auditor is unable to test a described control procedure because, for example, it has not operated during the year, the service auditor states the fact that no tests have been carried out and the reason in the description of tests attached to the Type 2 Report and considers whether this will affect their assurance opinion.

*Nature, Timing and Extent of Tests of Operating Effectiveness of Controls*

105. Tests of the operating effectiveness of controls, include:
- Enquiry of the appropriate personnel.
  - Observation of the application of the control procedure.
  - Inspection of relevant documentation evidencing operation of the control.
  - Re-performance of the control procedure.

Enquiry alone does not generally provide sufficient evidence to support a conclusion about the operating effectiveness of a specific control procedure.

106. The timing and extent of the service auditor's tests of controls varies with the characteristics of the population to be tested<sup>68</sup>, which includes the nature of the controls being tested (for example, manual or automated), the frequency of the operation of those controls (for example monthly, daily a number of times per day) and the expected rate of deviation, being the risk of failure of the control procedure that is being tested, is estimated in the service auditor's risk assessment. Tests of operating effectiveness provide evidence that enables the service auditor to report on the entire period covered by the Type 2 Report. Certain controls may not have evidence of their operation that can be tested subsequently and accordingly, the

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<sup>68</sup> See ASAE 3402, paragraph 26.

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service auditor may need to observe the operation of such controls at various times throughout the reporting period.<sup>69</sup>

107. When the service organisation has implemented changes to the controls during the period, the service auditor evaluates whether the controls met the control objectives before and after the change and tests the operating effectiveness of the superseded controls as well as the replacement controls over the period covered by each control. The description of the service auditor's tests clearly states which controls have been tested.

*Sampling*

108. When the service auditor uses sampling, ASAE 3402<sup>70</sup> requires the service auditor to consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn, and determine a sample size sufficient to reduce sampling risk to an appropriately low level. In addition, items are required to be selected in such a way that each sampling unit in the population has a chance of selection, and if a designed procedure is not applicable to a selected item, procedures are performed on a replacement item. If the designed or alternative procedures cannot be applied, the selected item is required to be treated as a deviation.

*Nature and Cause of Deviations*

109. The service auditor is required under ASAE 3402,<sup>71</sup> to investigate the nature and cause of any deviations identified and determine whether identified deviations are within the expected rate of deviation and are acceptable. Additional testing of the control or of other controls is necessary to reach a conclusion on whether or not the controls relative to a particular control objective are operating effectively throughout the specified period.
110. In the extremely rare circumstances when the service auditor considers a deviation discovered in a sample to be an anomaly and

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<sup>69</sup> See ASAE 3402, paragraph A31.

<sup>70</sup> See ASAE 3402, paragraph 27.

<sup>71</sup> See ASAE 3402, paragraph 28.

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no other controls have been identified that allow the service auditor to conclude that the relevant control objective is operating effectively throughout the specified period, the service auditor obtains a high degree of certainty that such deviation is not representative of the population. The service auditor obtains this degree of certainty by performing additional procedures to obtain sufficient appropriate evidence that the deviation does not affect the remainder of the population.<sup>72</sup>

**The Work of an Internal Audit Function**

*Obtaining an Understanding of the Internal Audit Function*<sup>73</sup>

111. If the service organisation has an internal audit function, the service auditor is required to obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed to determine whether the internal audit function is likely to be relevant to the engagement.

*Determining Whether and to What Extent to Use the Work of the Internal Auditors*<sup>74</sup>

112. The service auditor determines whether the work of the internal auditors is likely to be adequate for purposes of the engagement and if so, the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures.
113. In determining whether the work of the internal auditors is likely to be adequate for purposes of the engagement, the service auditor evaluates the objectivity of the internal audit function, the technical competence of the internal auditors, whether the work of the internal auditors is likely to be carried out with due professional care and whether there is likely to be effective communication between the internal auditors and the service auditor.

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<sup>72</sup> See ASAE 3402, paragraph 29.

<sup>73</sup> See ASAE 3402, paragraph 30.

<sup>74</sup> See ASAE 3402, paragraph 31-33.

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114. In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures, the service auditor considers the nature and scope of specific work performed by internal auditors, the significance of that work to the service auditor's conclusions and the degree of subjectivity involved in the evaluation of the evidence gathered in support of those conclusions.

*Using the Work of the Internal Audit Function*<sup>75</sup>

115. In order for the service auditor to use specific work of the internal auditors, the service auditor evaluates and performs procedures on that work to determine its adequacy for the service auditor's purposes. The service auditor evaluates whether the work was performed by internal auditors having adequate technical training and proficiency, the work was properly supervised, reviewed and documented, adequate evidence was obtained to enable the internal auditors to draw reasonable conclusions, conclusions reached are appropriate in the circumstance and exceptions relevant to the engagement or unusual matters disclosed by the internal auditors are properly resolved.

*Effect on the Service Auditor's Assurance Report*<sup>76</sup>

116. If the work of the internal audit function has been used, the service auditor makes no reference to that work in the section of the service auditor's assurance report that contains the service auditor's opinion.
117. In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's assurance report that describes the service auditor's tests of controls and the results thereof includes a description of the internal auditor's work and of the service auditor's procedures with respect to that work.

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<sup>75</sup> See ASAE 3402, paragraph 34-35.

<sup>76</sup> See ASAE 3402, paragraph 36-37.

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*Other Information*

118. The service auditor reads any other information included in a document containing the service organisation's description of its system and the service auditor's report to identify material inconsistencies, if any, with that description. In addition, while reading the other information, the service auditor may become aware of an apparent misstatement of fact. ASAE 3402<sup>77</sup> requires the service auditor to take further appropriate action if, following discussion of the matter with the service organisation, the service organisation refuses to correct a material inconsistency or misstatement of fact.

*Subsequent Events*

119. The service auditor is required under ASAE 3402<sup>78</sup> to enquire as to whether the service organisation is aware of any events subsequent to the period covered by the service organisation's description of the investment management services system and up to the date of the Service Auditor's Type 2 Report that may have a significant effect on that report. If the service auditor is aware of such an event the service auditor discloses it in the assurance report if such an event and information about that event is not disclosed by the service organisation.
120. The service auditor does not have any obligation to perform any procedures regarding the description of the system, control objectives and related controls, or the suitability of design or operating effectiveness of controls after the date of the Service Auditor's assurance report.<sup>79</sup>

*Documentation*

121. In preparing sufficient, appropriate and timely documentation under ASAE 3402,<sup>80</sup> the service auditor prepares documentation that is

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<sup>77</sup> See ASAE 3402, paragraph 41-42.

<sup>78</sup> See ASAE 3402, paragraph 43.

<sup>79</sup> See ASAE 3402, paragraph 44.

<sup>80</sup> See ASAE 3402, paragraph 45.

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sufficient to enable an experienced service auditor, having no previous connection with the engagement, to understand:

- (a) the nature, timing and extent of the procedures performed;
- (b) the result of the procedures and the evidence obtained; and
- (c) significant matters arising during the engagement and the conclusions reached thereon.

122. In documenting the nature, timing and extent of assurance procedures performed, under ASAE 3402,<sup>81</sup> the service auditor records:

- (a) the identifying characteristics of the specific items or matters being tested;
- (b) who performed the procedures and the date such procedures were completed; and
- (c) who reviewed the work performed and the date and extent of such review.

123. If the service auditor uses specific work of the internal auditors, the service auditor is required<sup>82</sup> to document the conclusions reached regarding the evaluation of the adequacy of the work of the internal auditors, and the procedures performed by the service auditor on that work.

124. The service auditor documents discussions of significant matters with the service organisation and other parties including the nature of the significant matters discussed and when and with whom the discussions took place.<sup>83</sup>

125. If the service auditor has identified information that contradicts or is inconsistent with the service auditor's final opinion regarding a

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<sup>81</sup> See ASAE 3402, paragraph 46.

<sup>82</sup> See ASAE 3402, paragraph 47.

<sup>83</sup> See ASAE 3402, paragraph 48.

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significant matter, ASAE 3402<sup>84</sup> requires the service auditor to document how the service auditor addressed the contradiction or inconsistency in forming the final opinion.

126. The service auditor is required to assemble the documentation in an engagement file, complete the administrative process of assembling the final engagement file on a timely basis after the date of the service auditor's assurance report and to retain that documentation for its retention period.<sup>85 86</sup> If the service auditor needs to modify or add documentation after the assembly of the final engagement file, ASAE 3402<sup>87</sup> requires the service auditor to document the reasons for making the modifications and when and by whom they were made and reviewed.

*The Service Auditor's Assurance Report*

127. The service auditor's opinion is expressed in a written assurance report on controls attached to the service organisation's description of its system and assertion .
128. The Service Auditor's Type 1 or 2 Report, includes the following basic elements in accordance with ASAE 3402<sup>88</sup>:
- (a) a title that clearly indicates the report is an independent service auditor's assurance report;
  - (b) an addressee;
  - (c) identification of:
    - (i) the service organisations' description of its system and assertion;<sup>89</sup>

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<sup>84</sup> See ASAE 3402, paragraph 49.

<sup>85</sup> See ASAE 3402, paragraph 50.

<sup>86</sup> See ASAE 3402, paragraph 51

<sup>87</sup> See ASAE 3402, paragraph 52.

<sup>88</sup> See ASAE 3402, paragraph 53.

<sup>89</sup> See paragraph 5.

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- (ii) those parts of the description which are not covered by the service auditor's opinion;
  - (iii) if the description refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the service organisation's description of its system can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organisation;
  - (iv) if services are performed by a subservice organisation, the nature of activities performed by the subservice organisation as described in the service organisation's description of its system and whether the inclusive method or the carve-out method has been used in relation to them. Where the carve-out method has been used, a statement that the service organisation's description of its system excludes the control objectives and related controls at relevant subservice organisations, and that the service auditor's procedures do not extend to controls at the subservice organisation. Where the inclusive method has been used, a statement that the service organisation's description of its system includes control objectives and related controls at the subservice organisation, and that the service auditor's procedures extended to controls at the subservice organisation.
- (d) identification of the criteria, including the minimum control objectives provided in this guidance statement for the relevant investment management services;
  - (e) A statement that the report and, in the case of a type 2 report, the description of tests of controls are intended only

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for user entities and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by user entities themselves, when assessing the risks of material misstatements of user entities' financial reports/statements;

- (f) A statement that the service organisation is responsible for:
  - (i) Preparing the description of its system, and the accompanying assertion, including the completeness, accuracy and method of presentation of that description and that assertion;
  - (ii) Providing the investment management services covered by the service organisation's description of its system;
  - (iii) Stating the control objectives, including those for the relevant investment management services from this guidance statement, and if any minimum control objectives are omitted or modified providing an explanation of that omission or modification; and
  - (iv) Designing and implementing controls to achieve the control objectives stated in the service organisation's description of its system.
- (g) A statement that the service auditor's responsibility is to express an opinion on the service organisation's description, on the design of controls related to the control objectives stated in that description and, in the case of a type 2 report, on the operating effectiveness of those controls, based on the service auditor's procedures.
- (h) A statement that the engagement was performed in accordance with ASAE 3402 *Assurance Reports on Controls at a Service Organisation*, which requires that the service auditor comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether, in all material respects, the service organisation's description of its system is fairly presented

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and the controls are suitably designed and, in the case of a type 2 report, are operating effectively.

- (i) A summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion, and, in the case of a type 1 report, a statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and therefore no opinion is expressed thereon.
- (j) A statement of the limitations of controls and, in the case of a type 2 report, of the risk of projecting to future periods any evaluation of the operating effectiveness of controls.
- (k) The service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria:
  - (i) In the case of a type 2 report:
    - a. The description fairly presents the service organisation's system that had been designed and implemented throughout the specified period;
    - b. The controls related to the control objectives stated in the service organisation's description of its system were suitably designed throughout the specified period; and
    - c. The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

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- (ii) In the case of a type 1 report:
  - a. The description fairly presents the service organisation's system that had been designed and implemented as at the specified date; and
  - b. The controls related to the control objectives stated in the service organisation's description of its system were suitably designed as at the specified date.
- (l) The date of the service auditor's assurance report, which is no earlier than the date on which the service auditor has obtained sufficient appropriate evidence on which to base the opinion;
- (m) The name of the service auditor and location in the jurisdiction where the service auditor practices.

An example of a service organisation's description of its system and assertion is shown at Appendix 3.

In the case of a type 2 report, the service auditor's assurance report includes a separate section after the opinion, or an attachment, that describes the tests of controls that were performed and the results of those tests. In describing the tests of controls, the service auditor clearly states which controls were tested, identifies whether the items tested represent all or a selection of the items in the population, and indicates the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk assessments. If deviations have been identified, the service auditor includes the extent of testing performed that led to identification of the deviations, and the number and nature of the deviations noted. The service auditor reports deviations even if, on the basis of tests performed, the service auditor has concluded that the related control objective was achieved.

129. Management, or those charged with governance, is responsible for the completeness, accuracy, validity and method of presentation of the description of control objectives and controls. The description of controls includes controls that may be relevant to user entities. The

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service auditor may assist the service organisation in preparing the description; however, the representations in the description are the responsibility of management, or those charged with governance, of the service organisation.

The description of control objectives and controls does not necessarily address every service provided by the service organisation. The description presents a level of detail that may provide sufficient information for the user auditor to assess the risk of material misstatement and to design further audit procedures in response to the assessed risk and, in the case of Type 2 Reports, to assess the operating effectiveness of the controls as if a service organisation were not used. However, the description of controls need not be so detailed as to enable compromise of security or other controls.

*Describing Tests of Operating Effectiveness*

130. The Service Auditor's Type 2 Report includes a separate attachment that describes the service auditor's tests of controls and the results thereof. An explanation of the service auditor's description of the nature, timing and extent of tests applied to controls is in Appendix 4.
131. The service auditor uses the control objectives identified by the service organisation and the service organisation's description of the controls intended to achieve those objectives as a reference for describing the nature, timing and extent of tests carried out and the results of the tests in the attachment to the Service Auditor's Type 2 Report, although it is not necessary to list the controls and related control objectives in both the service organisation's description of its system and in the Service Auditor's Type 2 Report. The service auditor describes tests of operating effectiveness that provide sufficient information to support the service auditor's opinion as to whether the controls were operating effectively throughout the period or alternatively, the service auditor's opinion that the results constitute a significant deficiency.
132. The service auditor's description of the nature of tests performed may include enquiry, inspection, observation or re-performance of

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the described controls. The description of the extent of tests performed identifies whether the items tested represent a sample or all of the items in the population.

*Reporting Deviations*

133. ASAE 3402 requires the service auditor to report deviations even if, on the basis of tests performed, the service auditor has concluded that the related control objective was achieved. Deviations in the service organisation's controls identified by the service auditor may include:

- Control objectives that are incomplete or inappropriate as compared to the control objectives in this Guidance Statement for the relevant services.
- The description of controls is inaccurate or omits changes in controls (although this does not necessarily affect the suitability of design or operating effectiveness of the controls).
- Controls associated with stated control objectives are incomplete or inappropriate.
- A set of controls is not suitably designed to achieve a specified control objective.
- Certain controls are not operating effectively.

134. If deviations have been identified, the service auditor may include, in the attachment to their report on tests of controls:

- Information about causative factors, to the extent the service auditor has identified such factors.
- The current status of corrective actions, to the extent the service auditor has determined their status.

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*Modified Opinions*

135. If the service auditor concludes that:<sup>90</sup>
- (a) the service organisation's description of controls and control objectives does not fairly present, in all material respects, the system as designed and implemented;
  - (b) the controls related to the control objectives stated in the description are not suitably designed, in all material respects, to achieve the specified control objectives;
  - (c) in the case of a type 2 report, the controls tested did not operate effectively, in all material respects, or
  - (d) the service auditor is unable to obtain sufficient appropriate evidence;
- then the service auditor modifies their opinion, in accordance with ASAE 3402, and includes a clear description of all the reasons for the modification in their report.
136. Refusal by management, or those charged with governance, of the service organisation to provide the written representations considered necessary as described in paragraphs 95 to 98 may constitute a limitation on the scope of the engagement and service auditor considers the implications in forming the assurance opinion.

*Other Communication Responsibilities*

137. If the service auditor becomes aware of non-compliance with laws and regulations, fraud or uncorrected errors attributable to the service organisation that are not clearly trivial and may affect one of more user entities, the service auditor determines whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organisation is unwilling to do so, the service auditor takes appropriate action.

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<sup>90</sup> See ASAE 3402, paragraph 55.

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*Using the Work of Others*

138. When using the work of an expert, the service auditor complies with the requirements and refers to the guidance in ASAE 3000.
139. Whilst the service auditor does not make reference to the work of others in the assurance opinion, the service auditor refers to any work conducted by internal audit or an expert in performing tests of controls in the description of tests of controls and results thereof.

***Service Auditor Engagements to report on financial information***

140. If the service auditor is engaged to provide a Report on financial information, the service auditor issues a separate auditor's report in respect of each user entity concerning only that user entity's balances and/or transactions.
141. In performing an engagement to report on specified assertions or on a Statement the service auditor applies the Auditing Standards (ASAs) and reports on the engagement under ASA 805.
142. If the service auditor has prepared a Type 2 Report it provides the service auditor with assurance as to the reliability of controls over the investment management services which relate to the user entity's balances and/or transactions. Accordingly the service auditor may be able to reduce the extent of substantive testing that might otherwise be necessary in preparing a Service Auditor's Report on financial information.

*Acceptance and Continuance of an Audit Engagement*

143. Before accepting the engagement, the service auditor is required under ASA 210<sup>91</sup> to determine the acceptability of the financial reporting framework, which in the case of a single financial statement or element, includes determining whether application of the financial reporting framework will result in a presentation that provides adequate disclosures to enable the intended users to

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<sup>91</sup> See ASA 210 *Agreeing the Terms of Audit Engagements*, paragraph 6(a).

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understand the information conveyed and the effect of material transactions and events on the information conveyed.<sup>92</sup>

144. The service auditor also complies with Auditing Standard ASA 210 in agreeing the terms of engagement.<sup>93</sup> In addition to the matters specified in ASA 210, the engagement letter or other written agreement between the service auditor and the service organisation may include:

- The service auditor's responsibility to conduct the engagement with reference to this Guidance Statement.
- The service auditor's responsibility to report, in an attachment to the Service Auditor's Report, uncorrected misstatements which have been aggregated during the audit, other than amounts which are clearly trivial.
- Reference to the performance materiality level provided by the user auditor, if applicable.

Example engagement letters for engagements to report on specified assertions and on a Statement are included in Appendix 1 Examples 2 and 3 respectively.

*Ethical Requirements*

145. In accordance with Auditing Standard ASA 200, the service auditor is required to comply with relevant ethical requirements, including those pertaining to independence, when performing an audit of a Statement or specified assertions. Relevant ethical requirements are defined in ASA 102.<sup>94</sup>

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<sup>92</sup> See ASA 805, paragraph 8.

<sup>93</sup> See ASA 210, paragraphs 9 & 10.

<sup>94</sup> See ASA 102 *Compliance with Ethical Requirements when Performing Audits, Reviews and Other Assurance Engagements*.

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146. The service auditor considers the fundamental principles of professional ethics, relating to the engagement to be undertaken, which include:<sup>95</sup>
- (a) integrity;
  - (b) objectivity;
  - (c) professional competence and due care;
  - (d) confidentiality; and
  - (e) professional behaviour.
147. Where the service auditor is undertaking an audit of a Statement or specified assertion particular consideration needs to be given to any threats to independence with respect to the user entity since the service auditor is reporting on financial information of the user entity. Threats to independence with respect to the user entity may be present, such as self-interest or familiarity threats, notwithstanding that the user entity may not be an assurance customer of the service auditor.
148. In evaluating threats to independence and considering applicable safeguards, the service auditor considers the nature of the engagement. It may be sufficient, for example in the case of a restricted use report, to apply independence requirements in evaluating the independence of the engagement team members and their immediate and close family with respect to the user entity, along with limited consideration of the firm's interests and relationships with the user entity.
149. Examples of safeguards that may be considered appropriate by service auditors to manage identified threats to independence include:
- Prohibiting the holding of direct, or material indirect, financial interests in the user entity or its affiliates by

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<sup>95</sup> See ASA 102, paragraph A3.

**Guidance Statement GS 007 *Audit Implications of the use of Service Organisations for Investment Management Services***

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members of the service auditor's engagement team and their immediate and close family.

- Removal from the service auditor's engagement team of any personnel with a close relationship with directors, officers or employees of the user entity or its affiliates.

*Service Auditor's Reports on Financial Information*

150. Service Auditor's Reports on Specified Assertions or on a Statement, need to comply with the requirements in ASA 805 and as such include the basic elements of an Auditor's Report as set out in that standard. In addition to these elements, the service auditor includes:

- (a) identification of the specific assertions audited (if report is limited to specific assertions);
- (b) identification of the investment management services provided by the service organisation to the user entity;
- (c) a description of the responsible party's (management, or those charged with governance, of the service organisation) responsibilities for the investment management services provided to the user entity;
- (d) reference to the contract or service level agreement between the service organisation and the user entity for the investment management services provided; and
- (e) reference to the use of the report by the user entity and the user auditor.

Examples of a Service Auditor's Report on Specified Assertions is provided in Appendix 6 Example 1 and a Service Auditor's Report on a Statement is provided in Appendix 6 Example 2 of this Guidance Statement.

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*Information Excluded from the Service Auditor's Report*

151. When performing a audit engagement at a service organisation, the service auditor may restrict the audit procedures to information that is held by the service organisation on behalf of the user entity. The Statement, however, may include information which is provided by the fiduciary of the user entity or by another party to the service organisation for inclusion in the Statement. Documentation or other audit evidence may not be available at the service organisation to substantiate that information. Where certain information within the Statement has not been audited, the service auditor identifies that information and specifically excludes it from the scope of the audit opinion.

*Reporting of Matters of Governance Interest Arising in an Audit Engagement on Financial Information*

152. In the course of performing procedures for an audit engagement at a service organisation, the service auditor is required to communicate any of the following matters identified to those charged with governance on a timely basis:
- (a) significant deficiencies in internal control<sup>96</sup>;
  - (b) significant findings from the audit<sup>97</sup>;
  - (c) uncorrected misstatements and the effect they, individually or in aggregate, may have on the opinion in the auditor's report<sup>98</sup>; and
  - (d) fraud, identified or suspected involving management, employees who have significant roles in internal control or others where the fraud results in a material misstatement, as

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<sup>96</sup> See ASA 265 *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9.

<sup>97</sup> See ASA 260 *Communication with Those Charged with Governance*, paragraph 16.

<sup>98</sup> See ASA 450 *Evaluation of Misstatements Identified during the Audit* paragraph 12.

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well as any other matters related to fraud that are relevant to their responsibilities.<sup>99</sup>

153. In addition, the service auditor states in their report whether they have identified any uncorrected misstatements in the course of the audit, other than amounts which are clearly trivial, and, if so, details the uncorrected misstatements in an attachment to their report. An outline for an attachment on uncorrected misstatements is shown at Appendix 6, Example 2.
154. If the service auditor considers that any of the matters reported to those charged with governance of the service organisation may affect one or more user entity, the service auditor determines from the appropriate level of management whether this information has been communicated to the affected user entity or entities. If the matter is not communicated satisfactorily, the service auditor may consider whether it affects the service auditor's ability to conduct the engagement or necessitates a modification to the service auditor's report.

**Materiality to be Applied by the Service Auditor**

*Controls Engagements*

155. In applying the requirements of ASAE 3402<sup>100</sup> when conducting an assurance engagement to report on controls, the service auditor considers materiality with respect to the fair presentation of the description, the suitability of the design of controls and, in the case of a Type 2 report, the operating effectiveness of controls. The concept of materiality relates to the system being reported on, not to the financial reports of user entities. The concept of materiality is not applied when disclosing, in the description of the tests of controls, the results of those tests where deviations have been identified.<sup>101</sup>

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<sup>99</sup> See ASA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of a Financial Report*, paragraph 41 and 42.

<sup>100</sup> ASAE 3402, paragraph 19.

<sup>101</sup> See ASAE 3402, paragraphs A16-A18 for further guidance on materiality.

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156. Significant deficiencies in internal control relating to audits of financial reports are required to be reported to those charged with governance by the user auditor as noted in paragraph 59.
157. The service auditor is not in a position to identify significant deficiencies with respect to each user entity because the service auditor may not be aware of the conditions existing at user entities. The service auditor is required only to consider conditions that come to the service auditor's attention that preclude the service auditor from obtaining reasonable assurance that specified controls objectives would be achieved if the controls were operated as described. The service auditor reports deviations in the design or operation of controls that cause the non-achievement of specified control objectives. It is then the user auditor's responsibility to consider the effect of those deviations on the user auditor's risk assessment and whether the deviations noted represent significant deficiencies in controls with respect to the user entity.

*Audits of Financial Information*

158. When conducting an audit of specified assertions or a Statement, the service auditor considers materiality under ASA 320 in determining the nature, timing and extent of audit procedures and evaluating the effect of misstatements. The relevant benchmark, for investment management services, on which the service auditor bases materiality, under ASA 320, in most cases is either:
- (a) the assets of the user entity for which specific assertions are being audited;
  - (b) total assets of the user entity reported in the Statement; or
  - (c) net assets, where assets and liabilities are reported, of the user entity reported in the Statement.
159. The service auditor often applies a percentage to the benchmark as a starting point in determining materiality under ASA 320.<sup>102</sup> In the absence of a materiality specified by the user auditor, the service

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<sup>102</sup> See ASA 320, paragraph A3.

**Guidance Statement GS 007 *Audit Implications of the use of Service Organisations for Investment Management Services***

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auditor may apply a percentage of 0.5% to any of the benchmarks listed in paragraph 142 as a reasonable basis for determining performance materiality for auditing specified assertions or a Statement, where investment management services are provided. Where an alternative benchmark is used, this percentage may not be appropriate for determining materiality.

160. If the user auditor requests that an alternative benchmark or percentage be used as a basis for determination of performance materiality to be applied by the service auditor, then this is communicated by the user entity to the service organisation and agreed between the service organisation and the service auditor.

**Conformity with International Pronouncements**

161. There is no equivalent International Standard on Auditing or International Practice Statement to this Guidance Statement.

Draft

## **Appendix 1**

(Ref: Para. )

### **ENGAGEMENT LETTERS**

The following example engagement letters are is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in GS 007. It will need to be varied according to individual requirements and circumstances. It is drafted to refer to an engagement for a single reporting period and would require adaptation if intended or expected to apply to recurring.<sup>103</sup> It may be appropriate to seek legal advice that any proposed letter is suitable.

#### **Example 1: Example Engagement Letter for a Type 2 Report on a Service Organisation's Controls**

To [the appropriate representative of management or those charged with governance] of XYZ Service Organisation:

*[The objective and scope of the engagement]*

You have requested that we report on the description of XYZ Service Organisation's [investment management services provided: custody; asset management, property management, superannuation member administration, investment administration or registry] system and management's assertion with respect to that description, which you will provide and which will accompany our report. The description of XYZ Service Organisation's [investment management services] system comprises control objectives and related controls designed to achieve those objectives for the period ended] [date]The control objectives included are the objectives for [investment management services] specified in Guidance Statement GS 007<sup>104</sup> and any additional objectives which are likely to be relevant to internal control as it relates to financial reporting of customers who have used the [investment management services] system.

We are pleased to confirm our acceptance and understanding of this engagement by means of this letter. Our engagement will be conducted with the objective of our expressing an opinion on the fair presentation of the

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<sup>103</sup> See ASA 210, paragraph 13.

<sup>104</sup> See GS 007 Appendix 2 Section B.

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Appendix 1, Example 1

[investment management services] system, suitability of the design of the controls to achieve the control objectives throughout the period and the operating effectiveness of the controls necessary to provide reasonable assurance that the control objectives were achieved throughout the period.

*[The responsibilities of the auditor]*

We will conduct our assurance engagement in accordance with Standard on Assurance Engagements ASAE 3402 *Assurance Reports on Controls at a Service Organisation* and with reference to Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services*. That standard requires that we comply with ethical and plan and perform procedures to obtain reasonable assurance about whether, in all material respects, XYZ Service Organisation's description of the [investment management services system is fairly presented, the controls are suitably designed, and operated effectively throughout the reporting period.

An assurance engagement involves performing procedures to obtain evidence about the description, design and operating effectiveness of controls. The procedures selected depend on the assurance practitioner's judgement, including the assessment of the risks of significant deficiencies in the [investment management services] system. The control objectives addressed, allied controls and procedures conducted to test those controls will be set out in an appendix to our report,

Because of the inherent limitations of an assurance engagement, together with the inherent limitations of any internal control system there is an unavoidable risk that some significant deficiencies may not be detected, even though the engagement is properly planned and performed in accordance with Standards on Assurance Engagements.

The system, within which the controls that we will test operate, will not be examined except to the extent the system is likely to be relevant to customers, as it relates to financial reporting. Hence no opinion will be expressed as to the effectiveness of the internal control system as a whole.

The work undertaken by us to form an opinion, is permeated by judgement, in particular regarding the nature, timing and extent of assurance procedures for gathering evidence and the drawing of conclusions based on the evidence gathered. In addition to the inherent limitations in any assurance

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Appendix 1, Example 1

engagement, which include the use of testing, inherent limitations of any internal control structure, and the possibility of collusion, most evidence is persuasive rather than conclusive. As a result, an assurance engagement can only provide reasonable – not absolute – assurance that the description is fairly presented, controls are suitably designed and controls have operated effectively throughout the period.

*The responsibilities of Management and identification of the applicable control framework*]Our assurance engagement will be conducted on the basis that [management or, where appropriate, those charged with governance] acknowledge and understand that they have responsibility:

- (a) For the preparation of a written assertion that, in all material respects, and based on suitable criteria:
  - (i) the description fairly presents the XYZ Service Organisation's [investment management services] system designed and implemented throughout the period;
  - (ii) The controls related to the control objectives stated in XYZ Service Organisation's description of its system were suitably designed throughout the specified period;
  - (iii) The controls related to the control objectives stated in XYZ Service Organisation's description of its system operated effectively throughout the specified period.
- (b) For design of the system, comprising controls which will achieve control objectives which are likely to be relevant to customers', who have used [the type or name of] system, internal control as it relates to financial reporting;
- (c) To provide us with:
  - (i) Access to all information of which those charged with governance and management are aware that is relevant to the design, implementation and operation of the [investment management services] system;

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Appendix 1, Example 1

- (ii) Additional information that we may request from those charged with governance and management for the purposes of this assurance engagement; and
- (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain evidence.

As part of our assurance process, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the engagement. XYZ Service Organisation’s description of the system will include the control objectives for [investment management services] set out in GS 007, but they may add to these to the extent that the control objectives are likely to be relevant to customers’, who have used [the type or name of] system, internal control as it relates to financial reporting. If [management/those charged with governance] consider any of the control objectives from GS 007 for [investment management services] are not applicable to XYZ Service Organisation, then they will include an explanation of the omission of that objective in XYZ Service Organisation’s description of the system.

*[Assurance Approach]*

We will examine and evaluate the control objectives and controls for [investment management services] system described above. The “Description of [investment management services] System” will include details of controls with which customers should comply. While our evaluation will include assessment of the appropriateness of the complementary customer controls, our testing will not encompass evaluation of the suitability of design or operating effectiveness of controls carried out by users of XYZ Service Organisation’s [investment management services] system. The control objectives stated in XYZ Service Organisation’s description of its system can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organisation.

Our procedures will extend to the control objectives and related controls at relevant subservice organisations only to the extent that those controls are included in XYZ Service Organisation’s description of [investment

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Appendix 1, Example 1

management services] system and are necessary to achieve the relevant control objectives.

Due to the complex nature of internal control, our assurance procedures will not encompass all individual controls at XYZ Service Organisation, but will be restricted to an examination of those controls reported which achieve the control objectives identified by XYZ Service Organisation's management in the "Description of the [investment management services] System" provided to us.

[Assurance Procedures]

Our assurance procedures are likely to include:

1. Performing a preliminary review of the control environment of XYZ Service Organisation relevant to the [investment management services] system;
2. Evaluating the reasonableness of the control objectives against the minimum objectives for [investment management services] provided in GS 007;
3. Evaluating the completeness, accuracy and presentation of the Description of the [investment management services] System against the controls implemented.
4. Evaluating the design of specific controls by:
  - (i) Assessing the risks that threaten the achievement of the control objectives.
  - (ii) Evaluating whether the controls described are capable of addressing those risks and achieving the related objectives.
5. Performing tests of controls to ascertain whether the degree of compliance with controls is sufficient to provide reasonable assurance that the controls have achieved their objectives throughout the period.

In undertaking this engagement, we shall work closely with XYZ Service Organisation's internal audit function and place reliance on their work in accordance with ASA 610 *Using the Work of Internal Auditors* [this

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Appendix 1, Example 1

paragraph is applicable where the work of internal audit is an integral part of the assurance engagement].

*[Assurance Report]*

The format of the report will be in accordance with ASAE 3402 and will include an opinion on the “Description of the [investment management services] System” by XYZ Service Organisation management and an accompanying description of the tests of controls that we performed and the results of those tests. . An example of the proposed report is contained in the appendix to this letter.

Our report will be issued [frequency] and will cover [period reported on] (paragraph is appropriate for recurring engagements).

The assurance report will be incorporated in a report issued by the XYZ Service Organisation containing information prepared by XYZ Service Organisation management to provide to customers and their auditors with an overall understanding of [subject matter]. ]. We will review the contents of the report issued by XYZ Service Organisation to identify any material inconsistencies with the Description of the [investment management services] System

*[Distribution of the Assurance Report]*

Our report and the accompanying description of tests of controls are intended only for customers of XYZ Service Organisation which use the [investment management services] system and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers’ financial reports.

Our assurance report will be prepared for this purpose only and we disclaim any assumption of responsibility for any reliance on our report to any person other than to XYZ Service Organisation’s customers and their auditors or for any purpose other than that for which it was prepared. be incorporated in a report issued by the XYZ Service Organisation containing information prepared by XYZ Service Organisation management to provide and their auditors with an overall understanding of [subject matter].

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Appendix 1, Example 1

*[Significant Deficiencies in Controls]*

We will issue an assurance report without modification, to provide reasonable assurance on the [investment management services] system where our procedures do not disclose a significant deficiency in the controls necessary to achieve the control objectives contained in the Description of the [investment management services] System by XYZ Service Organisation management. For this purpose, a significant deficiency exists when prescribed control procedures, or the degree of compliance with them:

- (a) does not provide XYZ Service Organisation management with reasonable assurance that the control objectives will be met or that fraud, error, or non-compliance with laws and regulations would be prevented or detected by employees in the normal course of their assigned functions; and
- (b) knowledge of that deficiency would be material to users of the assurance report.

If our assurance engagement discloses that there are significant deficiencies in the system of controls in operation during the period covered by the report, such deficiencies will be disclosed in our report even if they were corrected prior to the end of the reporting period. However, our report will indicate that such deficiencies were corrected if that is the case. If any significant deficiencies disclosed in our report have been corrected subsequent to this period (or are in the process of being corrected), we will refer to this in our report.

Although the primary purpose of our assurance engagement will be to enable us to issue the above described report, we will also periodically provide you with letters containing recommendations for strengthening controls if such matters are observed during the process of the assurance engagement. Although issues raised may not represent significant deficiencies in the system of controls, recommendations will address areas where we believe controls could be improved.

We look forward to full co-operation from your staff during our assurance engagement.

*[Other relevant information]*

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Appendix 1, Example 1

*[Insert additional information such as fee arrangements, billings and other specific terms, as appropriate.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our assurance engagement to report on the control procedures over XYZ Service Organisation's [investment management services] services to customers, including our respective responsibilities.

Yours faithfully,

[signed]

.....  
Name and Title

Date

Acknowledged on behalf of XYZ Service Organisation]

(signed)

.....  
Name and Title

Date

Appendix 1

**Example 2: Example Engagement Letter for an Audit of Specified Assertions**

To [the appropriate representative of management or those charged with governance] of the XYZ Service Organisation:<sup>105</sup>

*[The objective and scope of the audit]*

You<sup>106</sup> have requested that we audit the [specify assertions audited: for transactions or events: occurrence, completeness, accuracy, cut-off and classification; for balances: existence, rights and obligations, completeness or valuation and allocation; or for presentation and disclosure: occurrence, rights and obligations, completeness, classification and understandability and accuracy and valuation] of the assets [and liabilities or transactions] in the [title of the financial statement] of [user entity/entities] ("the Statement"), which comprises the [statement of assets and liabilities] as at [date], and the [statement of transactions] for the [period] then ended, concerning the assets and liabilities of [user entity/ies]<sup>107</sup> [nature of investment management services: managed by or in the custody of] [XYZ service organisation] as at [date].

We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the [specify assertions audited: existence, rights and obligations, completeness or valuation & allocation] of the assets [and liabilities or transactions] in the Statement.

*[The responsibilities of the auditor]*

We will conduct our audit in accordance with the Australian Auditing Standards, in particular ASA 805 *Special Considerations – Audit of Single*

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<sup>105</sup> The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons – see ASA 210 Paragraph A21.

<sup>106</sup> Throughout this letter, references to "you," "we," "us," "management," "those charged with governance" and "auditor" would be used or amended as appropriate in the circumstances.

<sup>107</sup> Where the assets are held in the name of a nominee holding company insert "held in the name of [nominee holding company]".

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 1, Example 2

*Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, and with reference to *GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services*. Those Standards require that we comply with ethical and plan and perform the audit to obtain reasonable assurance whether the Statement is free from material misstatement with respect to the assertions specified. This audit involves performing procedures to obtain audit evidence about the [specify assertions audited: existence, rights and obligations, completeness or valuation & allocation] of the assets [and liabilities or transactions] in the Statement. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement with respect to the [specify assertions audited: existence, rights and obligations, completeness or valuation & allocation] of the assets [and liabilities or transactions] in the Statement, whether due to fraud or error. An audit also includes evaluating the appropriateness of the financial reporting framework, accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the Statement with respect to the [specify assertions audited] of the assets [and liabilities or transactions] in the Statement.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with Australian Auditing Standards.

In making our risk assessments, we consider internal control relevant to XYZ Service Organisation's preparation of the Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Service Organisation's controls<sup>108</sup>. However, we will communicate to you in writing concerning any significant deficiencies in internal controls over financial reporting on behalf of [user entity/ies], that we have identified during the audit of the [specify

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<sup>108</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the Statement, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to [name of service organisation]'s preparation and fair presentation of the Statement in order to design audit procedures that are appropriate in the circumstances."

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 1, Example 2

assertions audited] of the assets [and liabilities or transactions] in the Statement.

We will report any uncorrected misstatements which we have aggregated during the audit but that were determined by management to be immaterial, both individually and in aggregate, to the Statement taken as a whole, other than amounts which are clearly trivial, in an attachment to our report.

*[The responsibilities of management and identification of the applicable financial reporting framework]*

Our audit will be conducted on the basis that management and, where appropriate, those charged with governance<sup>109</sup>, acknowledge and understand that they have responsibility:

- (a) For such internal control as [management] determines is necessary to enable the preparation of a Statement that is free from misstatement, whether due to fraud or error.
- (b) To provide us with:
  - (i) Access to all information of which those charged with governance and management are aware that is relevant to the preparation of the Statement such as records, documentation and other matters
  - (ii) Additional information that we may request from which those charged with governance and management for the purpose of the audit; and
  - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence

As part of our audit process, we will request from [management and, where appropriate, those charged with governance] written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

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<sup>109</sup> Use terminology as appropriate in the circumstances. For an audit under the *Corporations Act 2001*, the appropriate terminology is “the Directors”.

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 1, Example 2

*[Distribution of the Auditor's Report]*

We understand that our report may be incorporated in a report prepared by XYZ service organisation for distribution to the [Trustee/those charged with governance] of [user entity] for the purpose of fulfilling the [those charged with governance] of XYZ service organisation's reporting obligations under the [title of contract or service level agreement]. Our report will be prepared for this purpose only and we disclaim any assumption of responsibility for any reliance on our report, or on the Statement to which it relates, to any person other than [those charged with governance] of XYZ service organisation, [the Trustee/those charged with governance] of [customer] and their Auditor, or for any other purpose other than that for which it was prepared.<sup>110</sup>

*[Other relevant information]*

*[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]*

*[Reporting]*

*[Insert appropriate reference to the expected form and content of the auditor's report.]*

The form and content of our report may need to be amended in the light of our audit findings.

*Independence*

We confirm that, to the best of our knowledge and belief, the engagement team are independent of [user entity / user entities] in accordance with [specify relevant ethical requirements] in relation to the audit of the [specify assertions audited] of the assets [and liabilities or transactions] in the Statement. In conducting our audit of the [specify assertions audited] of the assets [and liabilities or transactions] in the Statement, should we become aware that we are not in compliance with the independence requirements of [specify relevant ethical requirements] we shall notify you on a timely basis.

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<sup>110</sup> Use of the report & liability limitation: insert additional wording, if any, required to reflect any liability arrangements agreed between the service auditor, the service organisation and other users, including confirmation of the purpose for which the service auditor's report has been prepared and the basis on which other parties may use the report.

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Appendix 1, Example 2

Please sign and return the attached copy of this letter to indicate your acknowledgement of and agreement with, the arrangements for our audit of [specify assertions audited] of the assets [and liabilities or transactions] in the Statement including our respective responsibilities

Yours faithfully,

(signed)

.....

Partner

Firm

Acknowledged and agreed on behalf of XYZ Service Organisation by

(signed)

.....

Name and Title

Date

Appendix 1

**Example 3: Engagement Letter for an Audit of a Statement**

To the appropriate representative of management or those charged with governance of the XYZ service organisation.<sup>111</sup>

*[The objective and scope of the audit]*

You<sup>112</sup> have requested that we audit the [title of financial statement] of [user entity/ies]<sup>113</sup> (“the Statement”), which comprises the [statement of assets and liabilities] as at [date], and the [statement of transactions] for the year then ended, concerning the assets [and liabilities or transactions] of [user entity/ies]<sup>114</sup> [insert nature of investment management services: managed by or in the custody of] XYZ service organisation as at [date].

We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter. Our audit will be conducted with the objective of our expressing an opinion on the Statement.

*[The responsibilities of the auditor]*

We will conduct our audit in accordance with the Australian Auditing Standards, in particular ASA 805 *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, and with reference to GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services*. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Statement is free from material misstatement. [If the user auditor has provided a materiality level to apply in the audit insert: The performance materiality level, which we will apply in determining the nature, timing and extent of audit procedures and in evaluating the effect of misstatements identified, has

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<sup>111</sup> The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons – see ASA 210 Paragraph A21.

<sup>112</sup> Throughout this letter, references to “you,” “we,” “us,” “management,” “those charged with governance” and “auditor” would be used or amended as appropriate in the circumstances.

<sup>113</sup> If certain assertions are specifically excluded from the audit then insert: “except for [specify assertions excluded, e.g. presentation & disclosure] of the Statement”.

<sup>114</sup> Where the assets are held in the name of a nominee holding company insert “held in the name of [nominee holding company]”.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 1, Example 3

been provided by the auditor of [user entity] and is [x] percent of [total assets/net assets]. This audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Statement. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Statement, whether due to fraud or error. An audit also includes evaluating the appropriateness of the financial reporting framework, accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Statement.

Because of the other inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that even material misstatements not be detected, even though the audit is properly planned and performed in accordance with Australian Auditing Standards.

In making our risk assessments, we consider internal control relevant to XYZ Service Organisation's preparation of the Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Service Organisation's controls<sup>115</sup>. However, we will communicate to you in writing concerning any significant deficiencies in internal controls over financial reporting on behalf of [user entity], that we have identified during the audit of the Statement.

We will report any uncorrected misstatements which we have aggregated during the audit but that were determined by management to be immaterial, both individually and in aggregate, to the Statement taken as a whole, other than amounts which are clearly trivial, in an attachment to our report.

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<sup>115</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the Statement, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to [name of service organisation]'s preparation and fair presentation of the Statement in order to design audit procedures that are appropriate in the circumstances."

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 1, Example 3

*[The responsibilities of management and identification of the applicable financial reporting framework]*

Our audit will be conducted on the basis that [management and, where appropriate, those charged with governance]<sup>116</sup> acknowledge and understand that they have responsibility:

- (a) for the preparation of the Statement that gives a true and fair view in accordance with [specify framework]<sup>117</sup>.
- (b) For such internal control as [management] determines is necessary to enable the preparation of a Statement that is free from misstatement, whether due to fraud or error.
- (c) To provide us with:
  - (i) Access to all information of which those charged with governance and management are aware that is relevant to the preparation of the Statement such as records, documentation and other matters;
  - (ii) Additional information that we may request from which those charged with governance and management for the purpose of the audit; and
  - (iii) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [management and, where appropriate, from those charged with governance], written confirmation concerning representations made to us in connection with the audit.

We look forward to full cooperation from your staff during our audit.

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<sup>116</sup> Use terminology as appropriate in the circumstances.

<sup>117</sup> Insert “applicable Australian Accounting Standards” where multiple Australian Accounting Standards were applied; insert reference to a specific Australian Accounting Standard where appropriate (for example: “the measurement standards of AAS 25 Financial Reporting by Superannuation Plans.”); or “the accounting policies described in Note X to the Statement”.

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 1, Example 3

*[Distribution of the Auditor's Report]*

We understand that our report may be incorporated in a report prepared by XYZ Service Organisation for distribution to the [Trustee/those charged with governance] of [user entity] for the purpose of fulfilling the [those charged with governance] of XYZ Service Organisation's reporting obligations under the [title of contract or service level agreement]. Our report will be prepared for this purpose only and we disclaim any assumption of responsibility for any reliance on our report, or on the Statement to which it relates, to any person other than [those charged with governance] of XYZ Service Organisation, [the Trustee/those charged with governance] of [customer] and their Auditor, or for any other purpose other than that for which it was prepared.<sup>118</sup>

*[Other relevant information]*

*[Insert other information, such as fee arrangements, billings and other specific terms, as appropriate.]*

*[Reporting]*

*[Insert appropriate reference to the expected form and content of the auditor's report.]*

The form and content of our report may need to be amended in the light of our audit findings.

*Independence*

We confirm that, to the best of our knowledge and belief, the engagement team is independent of [user entity/user entities] in accordance with [specify relevant ethical requirements] in relation to the audit of the Statement. In conducting our audit of the Statement, should we become aware that we have contravened the independence requirements of [specify relevant ethical requirements] we shall notify you on a timely basis.

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<sup>118</sup> Use of the report & liability limitation: insert additional wording, if any, required to reflect any liability arrangements agreed between the service auditor, the service organisation and other users, including confirmation of the purpose for which the service auditor's report has been prepared and the basis on which other parties may use the report.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 1, Example 3

Please sign and return the attached copy of this letter to your acknowledgement of, and agreement with, the arrangements for our audit of the Statement including our respective responsibilities.

Yours faithfully,

(signed)

.....

Partner

Firm

Acknowledged and agreed on behalf of [XYZ Service Organisation] by

(signed)

.....

Name and Title

Date

## **Appendix 2**

(Ref: para)

### **SERVICE ORGANISATION'S TYPE 2 CONTROLS ASSERTION AND DESCRIPTION OF THE SYSTEM**

The following example is for use as a guide only, in conjunction with the considerations described in GS 007, and are not intended to be exhaustive or applicable to all situations.

#### **XYZ Service Organisation's Type 2 Assertion on the [Investment Management Services] System**

Assertion by the Service Organisation

The accompanying description has been prepared for customers who have used [the type or name of] system and their auditors who have a sufficient understanding to consider the description, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers' financial reports/statements. [Entity's name] confirms that:

The accompanying description at pages [bb-cc] fairly presents [the type or name of] system for processing customers' transactions throughout the period [date] to [date]. The criteria used in making this assertion were that the accompanying description:

Presents how the system was designed and implemented, including:

- The types of services provided, including, as appropriate, classes of transactions processed.
- The procedures, within both information technology and manual systems, by which those transactions were initiated, recorded, processed, corrected as necessary, and transferred to the reports prepared for customers.
- The related accounting records, supporting information and specific accounts that were used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information was transferred to the reports prepared for customers.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 2

- How the system dealt with significant events and conditions, other than transactions.
- The process used to prepare reports for customers.
- Relevant control objectives and controls designed to achieve those objectives, including the control objectives for [investment management services] provided in Guidance Statement 007 Audit Implications of the Use of Service Organisations for Investment Management Services] except for [number excluded] control objectives for the reasons set out in the attached Description of Controls in Operation].<sup>119</sup> Controls that we assumed, in the design of the system, would be implemented by customers, and which, if necessary to achieve control objectives stated in the accompanying description, are identified in the description along with the specific control objectives that cannot be achieved by ourselves alone.
- Other aspects of our control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that were relevant to processing and reporting customers' transactions.

Includes relevant details of changes to the service organisation's system during the period [date] to [date].

Does not omit or distort information relevant to the scope of the system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment.

The controls related to the control objectives stated in the accompanying description were suitably designed and operated effectively throughout the period [date] to [date]. The criteria used in making this assertion were that:

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<sup>119</sup> Insert if certain control objectives specified in this Guidance Statement are not met by relevant controls.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 2

The risks that threatened achievement of the control objectives stated in the description were identified;

The identified controls would, if operated as described, provide reasonable assurance that those risks did not prevent the stated control objectives from being achieved; and

The controls were consistently applied as designed, including that manual controls were applied by individuals who have the appropriate competence and authority, throughout the period [date] to [date].

Signed on behalf of [Management/Those Charged with Governance]

Date

Appendix 2

**ATTACHMENT 1: XYZ Service Organisation's Description of the [Investment Management Services] System Accompanying XYZ Service Organisation Management's Assertion**

**XYZ SERVICE ORGANISATION'S [INVESTMENT MANAGEMENT SERVICES] SYSTEM**

**Services Provided**

XYZ Service Organisation (XYZ) provides its customers with [Investment Management Services: custody; asset management, property management, superannuation member administration, investment administration or registry] services, which involves [describe services provided].

**The System**

The stated internal control objectives and related controls included in this report apply to XYZ operations as they relate only to [investment management] services. Specifically excluded from this report are controls within individual systems, controls executed at customer premises and other services provided by XYZ, including [other related services provided to customers].

The effectiveness of controls performed by customers of XYZ should also be considered as part of the overall system of control relating to XYZ's [investment management] services.

[Describe, as appropriate:<sup>120</sup>

- *The procedures, within both information technology and manual systems, by which those transactions were initiated, recorded, processed, corrected as necessary, and transferred to the reports prepared for customers.*
- *The related accounting records, supporting information and specific accounts that were used to initiate, record, process and report transactions; this includes the correction of incorrect information*

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<sup>120</sup> Aspects of the system to be described here relate to the manner in which the system operates to provide services to customers but do not include specific controls which are designed to achieve the control objectives.

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 2

*and how information is transferred to the reports prepared for customers.*

- *How the system dealt with significant events and conditions, other than transactions.*
- *The process used to prepare reports for customers.*

*This may include a description of the flow of transactions or a flowchart].*

**[Controls at Subservice Organisations]<sup>121</sup>**

[XYZ uses [name of subservice organisation] to provide [type or name of] services, which form part of the [investment management services ] system used by XYZ customers. The [type or name of] services provided by [subservice organisation] are [describe the nature of the services provided]. XYZ's description of the system includes XYZ's monitoring controls over the operating effectiveness of the controls at [subservice organisation] and [includes/excludes]<sup>122</sup> the relevant control objectives and related controls of [subservice organisation].]

**Internal Control Objectives and Related Controls**

We set out in this report the control objectives and related controls implemented for XYZ. The specific controls set out in the remainder of the report have been designed to achieve each of the control objectives. The controls have been in place throughout the period from [date] to [date] unless otherwise indicated.

The Controls which were in operation at XYZ throughout the period from [date] to from [date], or during a lesser period where specified, to ensure that the identified Control Objectives over [investment management services] are achieved were:

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<sup>121</sup> Insert this section if XYZ Service Organisation uses a subservice organisation which performs some of the services provided to customers which use the system.

<sup>122</sup> Use "includes" if the inclusive method is used and "excludes" if the carve-out method is used with respect to the subservice organisation's services.

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 2

**Internal Control Objective**

[Control objectives, including those for the relevant investment management services from GS 007 Appendix 2 Section B.]<sup>123</sup>

**Related Controls**

[List controls in operation during the specified period relating to each control objective]

***[Period of operation: If the control has not been in operation the entire period or has changed, state the period during which the control was operating and the period during which the change was effective.]***<sup>124</sup>

***[Complementary customer controls: Describe any complementary user entity controls contemplated in the design of the controls.]***<sup>125</sup>

[The description may be presented in various formats such as narratives, flowcharts, tables or graphics, with an indication of the extent of manual and computer processing used.]

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<sup>123</sup> Where the control objective is excluded, insert: “This control objective is not relevant to the operations of [service organisation]’s [investment management services] and so has not been addressed by the controls because [specify reasons]”

<sup>124</sup> This section should be inserted for each control which has not been in operation for the whole period or has changed during the period.

<sup>125</sup> This section should be inserted for each control for which there are complementary user entity controls contemplated in the design of the control.

**Appendix 3**

(Ref: para)

**MINIMUM CONTROL OBJECTIVES FOR EACH INVESTMENT MANAGEMENT SERVICE**

This section sets out detailed control objectives for the investment management services referred to in GS 007 paragraph 8 and further defined below. The control objectives listed are the minimum objectives which the service auditor and users of a Type 1 or 2 Report may reasonably expect to be addressed in the service organisation's description of its system but are not intended to be exhaustive. It remains the responsibility of management, or those charged with governance, of the service organisation] to ensure that the described control objectives are likely to be relevant to customer's controls as they relate to financial reporting.

**A. Custody**

**Definition:**

"Custody" is the performance of the following functions on behalf of user entities:

- Maintaining custody of assets and records of the assets held for user entities (Such assets may exist in physical or electronic form).
- Collecting income and distributing such income to user entities.
- Receiving notification of corporate events and reflecting such events in the records of user entities.
- Receiving notification of asset purchase and sale transactions on behalf of user entities for which the custodian is holding assets, and reflecting such transaction in the records of user entities.
- Receiving payments from purchasers and disbursing proceeds to sellers for asset purchase and sale transactions.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 3

**Control Objectives:**

**Accepting customers**

- A1. Accounts are set up completely and accurately in accordance with customer agreements and applicable regulation, if any.
- A2. Complete and authorised customer agreements are established prior to initiating custody activity.
- A3. Investment holdings and related history (where applicable) transferred from prior custodians are received and recorded completely, accurately and on a timely basis.

**Authorising and processing transactions**

- A4. Investment and related cash and foreign exchange transactions are authorised and recorded completely, accurately and on a timely basis in accordance with customer instructions.
- A5. Investment and related cash and foreign exchange transactions are settled completely, accurately and on a timely basis and failures are resolved in a timely manner.
- A6. Corporate events and voting instructions are identified, actioned, processed and recorded on a timely basis.
- A7. Cash receipts and payments are authorised, processed and recorded completely, accurately and on a timely basis.
- A8. Securities lending programs are authorised and loan initiation, maintenance and termination are recorded on an accurate and timely basis.
- A9. Loans are collateralised in accordance with the lender's agreement and the collateral together with its related income is recorded completely, accurately and on a timely basis.
- A10. Collateral is completely and accurately invested in accordance with the lender's agreement.

Appendix 3

**Maintaining financial and other records**

- A11. Accounts are administered in accordance with customer agreements and applicable regulations.
- A12. 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.
- A13. Investment income and related tax reclaims are collected and recorded accurately and on a timely basis.
- A14. Asset positions for securities held by third parties such as sub custodians and depositories are accurately recorded and regularly reconciled.

**Safeguarding assets**

- A15. Assets held (including investments held with depositories, cash and physically held assets) are safeguarded from loss, misappropriation and unauthorised use.
- A16. Assets held are appropriately registered and segregated from the custodian's own assets and assets of other customers..
- A17. [If the custodian also provides Asset Management or Investment Administration services: Appropriate segregation exists between the custodian's Asset Management/Investment Administration and Custodian operations to ensure that asset management personnel do not have custody, control or access to assets or to confidential information of the Custodian's other customers.]

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 3

**Monitoring compliance**

- A18. Sub-custodians and other out-sourced activities are approved and managed in accordance with the requirements of the customer agreement.
- A19. Transaction errors are rectified promptly.

**Reporting**

- A20. Customer reporting in respect of customer asset holdings is complete and accurate and provided within required timescales.
- A21. Asset positions and details of securities lent are reported to interested parties accurately and within the required time scale, including those responsible for initiating voting instructions.

**Monitoring Subservice Organisations<sup>126</sup>**

- A22. The controls at sub-custodians over custody of XYZ Service Organisation's customer's assets are operating effectively throughout the period.

**Information technology**

G.1 – G.14

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<sup>126</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations..

Appendix 3

**B. Asset Management**

**Definition:**

“Asset management” is the investment of money on behalf of customers and involves the performance of the following functions:

- Initiating and executing purchase and sale transactions, either by specific direction from the customer or under discretionary authority granted by the customer .
- Determining whether transactions comply with guidelines and restrictions.
- Reconciling records of security transactions and portfolio holdings, for each customer, to statements received from the custodian.
- Reporting to the customer on portfolio performance and activities.
- Asset management includes hedge funds and private equity. Hedge funds are private investment funds that participate in a range of assets and a variety of investment strategies intended to protect the fund’s investors from downturns in the market while maximising returns on market upswings. Private equity is an asset class that is not publicly traded on a stock exchange. Control objectives specific to hedge funds and private equity are indicated.

**Control Objectives:**

**Accepting customers**

- B.1** Accounts are set up completely and accurately in accordance with customer agreements and applicable regulations, if any.
- B.2** Complete and authorised customer agreements, including investment guidelines and restrictions, are established prior to initiating investment activity.
- B.3** For hedge funds: New hedge funds are properly structured and authorised (where applicable), take account of legal and tax requirements and contain a specified investment strategy.

Appendix 3

**Authorising and processing transactions**

- B.4** Asset investment transactions are properly authorised, executed and allocated in a timely and accurate manner.
- B.5** Transactions are undertaken only with approved counterparties.
- B.6** Asset investment and related cash transactions are completely and accurately recorded and settled in a timely manner.
- B.7** Corporate events and proxy voting instructions are identified and generated, respectively, and then actioned, processed and recorded accurately and in a timely manner.
- B.8** Customer new monies and withdrawals are processed and recorded completely and accurately, withdrawals are appropriately authorised.

**Maintaining financial and other records**

- B.9** Accounts are administered in accordance with customer agreements.
- B.10** Changes to significant non-monetary customer data (for example, address changes and changes in allocation instructions) are authorised and correctly recorded on a timely basis.
- B.11** Investment income and related tax are accurately recorded in the proper period.
- B.12** Investments are valued using current prices obtained from independent external pricing sources or an alternative basis in accordance with customer agreements in circumstances where independent sources are not available.
- B.13** Cash and securities positions are completely and accurately recorded and reconciled to third party data.
- B.14** Investment management fees and other account expenses are accurately calculated and recorded in accordance with customer agreements.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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Appendix 3

**Segregation of assets**

- B.15** Investments are properly registered and customer money is segregated.

**Monitoring compliance**

- B.16** Customer portfolios are managed in accordance with investment objectives, monitored for compliance with investment guidelines and restrictions and performance is measured.

- B.17** Asset management services provided are approved, managed in accordance with the requirements of the customer agreement and conflicts of interest identified to customers.

- B.18** Transaction errors (including guideline breaches) are rectified promptly and customers treated fairly.

- B.19** Counterparty exposures are monitored.

**Reporting to customers**

- B.20** Customer reporting in respect of portfolio transactions, holdings and performance, brokerage and voting is complete and accurate and provided within required timescales.

**Monitoring Subservice Organisations<sup>127</sup>**

- B.21** The controls at subservice organisations over asset management of XYZ Service Organisation's customer's investments are operating effectively throughout the period.

- B.22** ...

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<sup>127</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations..

Appendix 3

**Hedge Fund Asset Management**

Scope:

The following additional control objectives apply to hedge funds. Hedge funds are private investment funds that participate in a range of assets and a variety of investment strategies intended to protect the fund's investors from downturns in the market while maximising returns on market upswings.

Control Objectives:

**Accepting clients**

- B.23** New funds are properly structured and authorised (where applicable), take account of legal and tax requirements and contain a specified investment strategy.
- B.24** Funds are set up and administered in accordance with the Fund's constitutional agreements and applicable regulations.

**Authorising and processing transactions**

- B.25** Complete and authorised agreements with counterparties (e.g., prime broker, administrator and custodian) are operative prior to initiating investment activity
- B.26** Investor subscriptions and redemptions are processed and recorded completely and accurately; redemptions are appropriately authorised
- B.27** Where quantitative trading strategies are adopted, the design and review of such strategies / models is monitored.
- B.28** Trading activity is only undertaken within the parameters of the Fund's investment strategy (e.g., limits on leverage, concentration risk, counterparty risk, type of investments).

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**Maintaining financial and other records**

- B.29** Where reliable market price data is not available hard-to-value assets are valued using consistent valuation arrangements which mitigate conflicts of interest and are disclosed to investors.
- B.30** Reconciliations are undertaken between the prime broker, the administrator and the custodian for daily trades, investment positions, settlements and cash in a timely and accurate manner.
- B.31** Lock-up periods, redemption gates and penalties are accurately applied in accordance with the Fund's constitutional agreements.
- B.32** Where hard-to-value assets are placed in side pockets, they are appropriately identified and recorded in accordance with the Fund's constitutional agreements.

**Safeguarding assets**

- B.33** Liquidity management is undertaken with due regard to investor subscriptions and redemptions, margin calls, terms and duration of bank borrowing and the payments due to creditors

**Monitoring compliance**

- B.34** Portfolio liquidity is monitored in accordance with client instruction in order to meet redemption requests in a timely manner.
- B.35** Levels of leverage, margin calls, counterparty exposures and potential events of default are monitored.

**Reporting to investors**

- B.36** Reporting to investors in respect of fund net asset values, portfolio transactions, investment holdings, performance, commission and voting and other information agreed with investors is complete and accurate and provided with required timescales.

Appendix 3

**Asset Management - Private Equity**

**Scope:**

“Private Equity” is an asset class that is not publicly traded on a stock exchange and consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public company.

**Control Objectives:**

**Accepting clients**

- B.37** New funds are properly developed and authorised, take account of legal and tax requirements and contain a specified investment strategy.
- B.38** Prospective investors are assessed for suitability and complete relevant legal documentation prior to investment activity.
- B.39** Investment guidelines and restrictions are established and updated as required.

**Authorising and processing investment transactions**

- B.40** Investment decisions are researched, authorised and implemented in accordance with the investment strategy and due diligence and abort costs are controlled.
- B.41** Investment transactions and commitments are properly authorised and executed in a timely and accurate manner (this is intended to include acquisitions and exits).
- B.42** Investment and related cash transactions are completely and accurately recorded and communicated for settlement in a timely manner.
- B.43** Rights and obligation arising from an exit are recorded and monitored

Appendix 3

- B.44** Investment allocations are made in accordance with the terms of the partnership or supporting agreements

**Maintaining financial and other records**

- B.45** Investment income and related tax are accurately recorded in the proper period
- B.46** Investments are valued in accordance with relevant industry guidelines
- B.47** Investor drawdowns and distributions are authorised, processed and recorded completely and accurately
- B.48** Investment management fees, carried interest payments and expenses of the funds are authorised, accurately calculated, recorded and allocated in accordance with the fund's legal documentation
- B.49** Cash and investment positions are completely and accurately recorded and reconciled to third party data or documents of title held

**Safeguarding assets**

- B.50** Investments are properly registered and securely held.
- B.51** Uninvested cash is managed with due regard to diversification of risk and security of funds.

**Monitoring compliance**

- B.52** Investment performance is monitored.
- B.53** Outsourced activities are properly managed and monitored and conflicts of interest identified to clients.

**Reporting to investors**

- B.54** Investor reporting is complete and accurate and provided within required timescales.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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**B.55** Reports and accounts are prepared having regard to disclosure requirements and submitted in accordance with timescales determined by applicable law and regulations and are distributed to investors on a timely basis

**Information technology**

**G.1 – G.14**

Draft

Appendix 3

**C. Property Management**

**Definition:**

“Property management” is the performance of the following functions:

- Initiating and executing property purchase and sale transactions either by specific direction from the customer or under discretionary authority granted by the customer.
- Determining whether transactions comply with guidelines and restrictions.
- Reconciling records of transactions for each customer, to statements received from the custodian.
- Reporting to the customer on performance and activities.

**Control Objectives:**

**Accepting customers**

- C.1** Accounts are set up completely and accurately in accordance with customer agreements and applicable regulations, if any.
- C.2** Complete and authorised customer agreements are established prior to initiating investment activity.
- C.3** Investment guidelines and restrictions are established and agreed prior to investment management activity.
- C.4** Pooled fund unitholder activity is recorded completely, accurately and in a timely manner.

**Authorising and processing transactions**

- C.5** Investment decisions are properly formulated in accordance with investment guidelines, authorised, implemented and reviewed on a timely basis.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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- C.6** Property developments are only undertaken in accordance with acceptable risk criteria.
- C.7** Costs associated with buying and selling properties are authorised and recorded accurately.
- C.8** Tenants' covenants and lease conditions are assessed and authorised on a timely basis.
- C.9** Property and related cash transactions are completely and accurately recorded and settled in a timely manner.
- C.10** Rental income and service charges are accurately calculated and recorded on a timely basis.
- C.11** Customer new monies and withdrawals are authorised, processed and recorded completely and accurately.

**Maintaining financial and other records**

- C.12** Accounts are administered in accordance with customer agreements and applicable regulations.
- C.13** Changes to significant non-monetary customer data (for example, address changes and changes in allocation instructions) are authorised and correctly recorded on a timely basis.
- C.14** Complete and accurate records of each property are maintained.
- C.15** Valuations are obtained at regular intervals from independent external valuers.
- C.16** Income entitlements are received in full, wherever possible, and expenses, both recoverable and irrecoverable, are controlled.
- C.17** Property management fees and other account expenses are accurately calculated and recorded.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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- C.18** Rents are monitored and rent reviews are recorded promptly and accurately.
- C.19** Pooled funds are priced and administered accurately and in a timely manner.

**Safeguarding assets**

- C.20** Properties purchased are of good and marketable title.
- C.21** Title deeds are safeguarded from loss, misappropriation and unauthorised use.
- C.22** Uninvested cash is managed with due regard to diversification of risk and security of funds.
- C.23** Risks arising from investing in property are insured where this is economic to the interests of owners (for example consider claims etc. arising from the public where large shopping malls are owned).

**Monitoring compliance**

- C.24** Customer portfolios are managed in accordance with investment objectives, monitored for compliance with investment guidelines and restrictions and performance is measured.
- C.25** Property management services provided are approved and managed in accordance with the requirements of the customer agreement.
- C.26** Transaction errors (including guideline breaches) are rectified promptly and customers treated fairly.

**Reporting to customers**

- C.27** Customer reporting in respect of property transactions, holdings and performance is complete and accurate and provided within required timescales.

**Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services***

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**Monitoring Subservice Organisations<sup>128</sup>**

**C.28** The controls at subservice organisations over property management of XYZ Service Organisation's customer's property are operating effectively throughout the period.

**Information technology**

G.1 – G.14

Draft

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<sup>128</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations..

## **D. Superannuation Member Administration**

### **Definition:**

“Superannuation member administration” is the performance of the following functions:

- Maintaining membership data, including the addition of new members and updating existing members’ data.
- Receiving contributions and transfers in from employers, members or government and allocating to members accounts.
- Calculation and payment of benefits to members, beneficiaries, other superannuation funds and/or other third parties where applicable (e.g. financial hardship).
- Receiving instructions from members and trustees regarding investment elections and investment switch requests, and communicating these instructions to other service organisations responsible for executing these instructions.
- Processing deductions from member accounts, including insurance premiums, administration fees and contribution tax, and remittance of expenses and tax to appropriate parties.
- Liaison with insurers regarding insurance claims, receipt of insurance proceeds and payment of death, TPD and income protection benefits.
- Allocation of fund earnings to members’ accounts, through application of crediting rate or adjustment of unit prices.
- Annual review of fund, including roll up of members’ accounts and calculation of vested benefits/accrued benefits and annual reporting to members and trustees.

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Appendix 3

Where the service organisation maintains financial records in addition to member records, the control objectives in Appendix 2 Section E Investment Administration will be applicable.

**Control Objectives:**

**Accepting customers**

- E.1** Accounts for superannuation funds and sub-plans are set up completely and accurately in accordance with customer agreements and applicable regulations, if any.
- E.2** Member accounts are set up completely and accurately in accordance with fund rules and individual investment and insurance elections.

**Authorising and processing transactions**

- E.3** Contributions and transfers in are correctly classified and allocated to members' accounts, processed accurately and on a timely basis.
- E.4** Superannuation benefits payable and transfer values are calculated and recorded accurately and are paid on a timely basis.
- E.5** Instructions from members and trustees regarding investment elections and investment switch requests are actioned and accurately processed.
- E.6** Deductions from member accounts, including insurance premiums, administration fees and contribution tax, are calculated in accordance with member elections, fund rules, relevant legislation and regulations and accurately recorded.
- E.7** Expenses and tax deducted are remitted to the appropriate parties.

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Appendix 3

**Maintaining member records**

- E.8** Changes to members' significant standing data (for example, address changes and changes in allocation instructions) are authorised and correctly recorded on a timely basis.
- E.9** Investment earnings are accurately allocated (through crediting rates or unit pricing) to member accounts and in accordance with trustee directions and fund rules.

**Safeguarding assets**

- E.10** Superannuation fund, sub-plan and member data is appropriately stored to ensure security and protection from unauthorised use.

**Monitoring compliance**

- E.11** Contributions are received in accordance with fund rules and relevant legislation.
- E.12** Transaction errors are identified, notified to members or trustees in accordance with customer agreements and rectified promptly if required.
- E.13** Benefits payable and transfer values are calculated and paid in accordance with superannuation fund rules, relevant legislation and regulations.
- E.14** Superannuation member administration provided to customers is approved and managed in accordance with the requirements of the customer agreement.

**Reporting to customers**

- E.15** Annual member statements issued to members are accurate and complete and distributed on a timely basis.

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Appendix 3

**Monitoring Subservice Organisations<sup>129</sup>**

**E.16** The controls at subservice organisations over superannuation member administration of XYZ Service Organisation's customer's superannuation scheme are operating effectively throughout the period.

**Information technology**

G.1 – G.14

Draft

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<sup>129</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations.

Appendix 3

**E: Investment Administration**

**Definition:**

“Investment Administration” is the performance of the following functions:

- Maintaining records of securities, cash, and other portfolio assets and liabilities based on information received from the Trustee/Responsible Entity, investment manager, registrar, custodian and others (as applicable).
- Valuations of portfolio assets and liabilities, determining net asset values and reporting thereof.
- Periodic reporting of performance and investment compliance to the Trustee/Responsible Entity, investment manager, and others (as applicable).
- Periodic financial reporting.

Unit pricing and crediting rate calculations are also a function performed in investment administration, for which the control objectives include the accurate calculation of daily or other periodic unit prices or crediting rates with detailed controls allied to that objective. This control objective has not been listed below, because it would not ordinarily be necessary to test these detailed controls in obtaining assurance over the operating effectiveness of controls over the investment administration services provided by a service organisation for the purpose of the audit of user entities’ financial reports.

**Control Objectives:**

**Accepting customers**

- E.1** Accounts are set up completely and accurately in accordance with customer agreements and applicable regulations, if any.
- E.2** Complete and authorised customer agreements are established prior to initiating accounting activity.

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**Authorising and processing transactions**

- E.3** Corporate actions are actioned, processed and recorded accurately and on a timely basis.

**Maintaining financial and other records**

- E.4** Accounts are administered in accordance with customer agreements.
- E.5** 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.
- E.6** Investment income and related tax are accurately calculated and recorded on a timely basis.
- E.7** Investments are valued in accordance with regulatory requirements, customer agreements or industry standard.
- E.8** Cash and securities positions are completely and accurately recorded and reconciled to third party data.
- E.9** Expenses are appropriately authorised and recorded in accordance with the service level agreement and/or customer instructions on a timely basis.
- E.10** Distribution rates are accurately calculated and authorised and distribution amounts are recorded in a timely manner.
- E.11** Issue and cancellations of shares/units are recorded completely and accurately, and positions are regularly reconciled.
- E.12** Reconciliations between different systems, including the investment ledger, general ledger and administration system, are performed on a timely basis.

**Monitoring compliance**

- E.13** Errors are identified, notified to customers and rectified promptly in accordance with customer agreements

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Appendix 3

**E.14** Investment administration services provided to customers are approved and managed in accordance with the requirements of the customer agreement and conflicts of interest identified to clients.

**E.15** Pricing and distribution rate errors are rectified in a timely manner.

**Reporting to customers**

**E.16** Periodic reports to customers, including calculation of net asset value if required, are accurate and complete and distributed on a timely basis.

**Taxation**

**E.17** Tax Policy is updated and reviewed on a timely basis.

**E.18** The general ledger or investment system is based on complete and accurate tax information in accordance with instructions received from the customer and/or their approved advisors.

**E.19** Distribution income receivable by customers is reported to customers based on tax policy and underlying tax records on a timely basis.

**E.20** Tax information components and attributes used in the preparation of the tax computation are complete and accurate and calculated on a timely basis in accordance with tax policy and/or client instructions (including: capital gains, TOFA, withholding tax, foreign income fund amounts, current and prior year tax losses, current and prior year timing differences, Section 115-45 securities, franking credits, foreign tax credits, Division 16E amounts).

**E.21** Current and deferred tax balances, as calculated for the financial statements, are materially correct and processed in a timely manner (where appropriate) ) in accordance with tax policy.

**E.22** Assets are completely and accurately classified as held on either a capital or a revenue account (where appropriate) ) in accordance with client instructions or tax policy.

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Appendix 3

**Monitoring Subservice Organisations<sup>130</sup>**

**E.23** The controls at subservice organisations over investment administration of XYZ Service Organisation's customer's investments are operating effectively throughout the period.

**Information technology**

G.1 – G.14

Draft

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<sup>130</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations.

Appendix 3

**F. Registry**

**Definition:**

“Registry” is the performance of the following functions:

- Maintaining records of the name and address of each shareholder or unitholder investing in the customer/issuer, the amount of shares or units in the customer owned by each share/unitholder, any reference corresponding to a share/unit holder’s positions, the issue date of the share/unit, and the cancellation date of the share/unit (if applicable).
- Recording the amount of shares/units purchased, redeemed, switched, transferred or reinvested by a shareholder or unitholder on the issuer’s books upon receipt of a validated request.
- Recording changes to share/unit holdings as a consequence of a corporate action upon receipt of a validated instruction.
- Monitoring the issuance of shares/units in an issue to prevent the unauthorised issuance of shares/units.
- Ensuring that any issuance of shares/units will not cause the authorised number of shares/units in an issue to be exceeded and that the number of new shares/units represented corresponds to the number of cancelled shares/units.
- Performing stakeholder meeting and voting processes such as document design and print procurement, postage, other distribution of documentation and reporting.

**Control Objectives:**

**Accepting customers**

- F.1** Accounts are set up completely and accurately in accordance with customer/issuers agreements.
- F.2** Complete and authorised customer agreements are established prior to initiating accounting activity.

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Appendix 3

**Authorising and processing transactions**

- F.3** New share/unitholder activity is clearly established and recorded completely, accurately and in a timely manner.
- F.4** Share/unitholder applications, redemptions and switches received are checked, sorted and distributed for processing in a timely manner.
- F.5** Share/unitholder transactions and adjustments are authorised, processed accurately, completely and in a timely manner.
- F.6** Cash receipts are processed accurately and banked promptly.
- F.7** Cheques and confirmation letters issued are accurately generated, matched and authorised prior to despatch.
- F.8** Where authorised capital is fixed, shares/units issued do not exceed the authorised number of shares in an issue and the number of new shares/units represented corresponds to the number of cancelled shares/units.

**Maintaining financial and other records**

- F.9** Accounts are administered in accordance with customer agreements.
- F.10** Changes to significant non-monetary share/unitholder data (for example, address changes and changes in allocation instructions) are authorised and correctly recorded on a timely basis.
- F.11** Share/unit activity is recorded completely, accurately and positions are regularly reconciled.
- F.12** Pooled funds are priced and administered accurately and in a timely manner in accordance with unitholders' agreements.

**Safeguarding assets**

- F.13** Lost and stolen certificates are recorded in a timely manner.

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 3

**Monitoring compliance**

- F.14** Transaction errors are identified, notified to customers and share/unit holders in accordance with customer agreements and rectified if necessary.
- F.15** Registry services provided to customers are approved and managed in accordance with the requirements of the customer agreement.

**Reporting to customers**

- F.16** Customer reporting is complete and accurate and processed within required timescales.

**Taxation**

- F.17** Distribution information is completely and accurately processed in the Registry system.
- F.18** Distribution payments are complete, accurate and processed in a timely manner.
- F.19** Withholding tax for non-residents, or where no TFN/ABN has been provided, is calculated completely, accurately and on a timely basis.

**Monitoring Subservice Organisations<sup>131</sup>**

- F.20** The controls at subservice organisations over registry of XYZ service organisation's share/unitholders are operating effectively throughout the period.

**Information technology**

G.1 – G.14

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<sup>131</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations.

Appendix 3

**G. Information Technology**

**Scope:**

Information technology (IT) control objectives are applicable to all investment management services as IT is integral to providing those services. The IT control objectives are addressed for each investment management service reported on, in addition to the specific control objectives that are provided for each investment management service in this Appendix.

**Control Objectives:**

**Restricting access to systems and data**

- G.1** Physical access to computer networks, equipment, storage media and program documentation is restricted to authorised individuals.
- G.2** Logical access to computer systems, programs, master data, customer data, transaction data and parameters, including access by administrators to applications, databases, systems and networks, is restricted to authorised individuals via information security tools and techniques.
- G.3** Segregation of incompatible duties is defined, implemented and enforced by logical security controls in accordance with job roles.

**Authorising and processing transactions**

- G.4** IT processing is authorised and scheduled appropriately and exceptions are identified and resolved in a timely manner.

**Safeguarding assets**

- G.5** Appropriate measures, including firewalls and anti-virus software, are implemented to counter the threat from malicious electronic attack.
- G.6** The physical IT equipment is maintained in a controlled environment.

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**Maintaining and developing systems hardware and software**

- G.7** Development and implementation of new systems, applications and software, and changes to existing systems, applications and software, are authorised, tested, approved, implemented and documented.
- G.8** Data migration or modification is authorised, tested and, once performed, reconciled back to the source data.

**Recovering from processing interruptions**

- G.9** Data and systems are backed up regularly, retained offsite and regularly tested for recoverability.
- G.10** IT hardware and software issues are monitored and resolved in a timely manner.
- G.11** Business and information systems recovery plans are documented, approved, tested and maintained.

**Monitoring compliance**

- G.12** Information technology services provided to customers are approved, managed and performance thresholds met in accordance with the requirements of the customer agreement.

**Monitoring Subservice Organisations<sup>132</sup>**

- A23. The controls at subservice organisations over information technology for XYZ Service Organisation's investment management services are operating effectively throughout the period.
- A24. ...

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<sup>132</sup> Include control objectives for monitoring subservice organisations when the carve -out method is used to deal with subservice organisations.

**Appendix 4**

(Ref: Para. )

**SERVICE AUDITOR'S TYPE 2 ASSURANCE REPORT**

**Independent Service Auditor's Assurance Report on the Description of Controls over [Investment Management Services], their Design and Operating Effectiveness**

To: XYZ Service Organisation

**Scope**

We have been engaged to report on XYZ Service Organisation's description at pages [bb-cc] of its [specify investment management services: custody, asset management, property management, superannuation member administration, investment administration or registry] system provided to XYZ service organisation's customers throughout the period [date] to [date] (the description), and on the design and operations of those controls related to the control objectives stated in the description.<sup>133</sup>

**XYZ Service Organisation's Responsibilities**

XYZ Service Organisation is responsible for: preparing the description and accompanying assertion at page [aa], including the completeness, accuracy and method of presentation of the description and assertion; providing the services covered by the description; stating the control objectives and designing, implementing and effectively operating controls to achieve the stated control objectives.

**Service Auditor's Responsibilities**

Our responsibility is to express an opinion on XYZ Service Organisation's description and on the design and operation of controls related to the control objectives stated in that description, including the minimum controls objectives for [investment management service/s] from Guidance Statement GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services*, based on our procedures. We conducted

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<sup>133</sup> If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

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our engagement in accordance with Standard on Assurance Engagements ASAE 3402 *Assurance Reports on Controls at a Service Organisation*, issued by the Auditing and Assurance Standards Board. That standard requires that we comply with relevant ethical requirements and plan and perform our procedures to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls are suitably designed and operating effectively.

An assurance engagement to report on the description, design and operating effectiveness of controls at a service organisation involves performing procedures to obtain evidence about the disclosures in the service organisation's description of its system, and the design and operating effectiveness of controls. The procedures selected depend on our judgement, including the assessment of the risks that the description is not fairly presented, and that controls are not suitably designed or operating effectively. Our procedures included testing the operating effectiveness of those controls that we consider necessary to provide reasonable assurance that the control objectives stated in the description were achieved. An assurance engagement of this type also includes evaluating the overall presentation of the description, the suitability of the objectives stated therein, and the suitability of the criteria specified by the service organisation and described at page [aa].

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Limitations of Controls at a Service Organisation**

XYZ Service Organisation's description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment. Also, because of their nature, controls at a service organisation may not prevent or detect all errors or omissions in processing or reporting transactions. Also, the projection of any evaluation of effectiveness to future periods is subject to the risk that controls at a service organisation may become inadequate or fail.

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Appendix 4

**Opinion**

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion are those described at page [aa]. In our opinion, in all material respects:

The description fairly presents the [investment management services] system as designed and implemented throughout the period from [date] to [date];

The controls related to the control objectives stated in the description were suitably designed throughout the period from [date] to [date]; and

The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period from [date] to [date].

**Description of Tests of Controls**

The specific controls tested and the nature, timing and results of those tests are listed on pages [yy-zz].

**Intended Users and Purpose**

This report and the description of tests of controls on pages [yy-zz] are intended only for customers who have used XYZ Service Organisation's [type or name of] system, and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers' financial reports/statements.

*[Service Auditor's signature]*

*[Date of the service auditor's assurance report]*

*[Service auditor's address]*

## **Appendix 5**

(Ref: Para. )

### **SERVICE AUDITOR'S DESCRIPTION OF THE NATURE, TIMING AND EXTENT OF TESTS APPLIED TO CONTROLS**

The description does not duplicate the service auditor's detailed assurance programme, since that would provide more than the appropriate level of detail. There is no standardised format for presenting a description of tests applied to controls, however the following elements are ordinarily included in the description:

1. Cross reference to the control objectives and allied controls<sup>134</sup> intended to achieve those objectives described in the service organisation's description of its system.
2. Assessment of the fair presentation of the description, including:
  - (b) identification of any inadequacies, omissions or inaccuracies in the description of control objectives;
  - (c) identification of any inaccuracies in the description of controls, as designed and implemented.
3. Assessment of the suitability of the design, including identification of any inadequacies in the design of the controls to achieve their stated objectives.
4. Tests of operating effectiveness, including:
  - (a) nature, timing and extent of tests conducted including whether the whole population was tested or a sample, in this case the size of the sample;
  - (b) number and nature of exceptions noted;
  - (c) remedial action taken by management, if any; and

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<sup>134</sup> If applicable, complementary user entity controls would also be described.

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- (d) results of the tests in sufficient detail to enable user auditors to assess the effect of those tests on their assessment of control risk.

**Description of nature of tests**

The nature of tests carried out by the service auditor may include such procedures as enquiry, inspection, observation and re-performance. Examples of descriptions of these procedures, which may assist the service auditor in describing tests of controls are set out below.

1. Enquiry:

- Enquired of appropriate XYZ Service Organisation personnel.
- Conducted enquiries seeking relevant information or representation from personnel were performed to obtain, among other things:
  - Knowledge, additional information and affirmation regarding the control of procedures.
  - Corroborating evidence of the controls.

2. Inspection:

- Inspected documents and records indicating performance of the controls. This included, among other things:
  - Inspection of reconciliations and management reports that age and/or quantify reconciling items to assess whether balances and reconciling items appear to be properly monitored, controlled and resolved on a timely basis, as required by the related control.

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- Examination of source documentation and authorisations related to selected transactions processed.
  - Examination of documents or records for evidence of performance, such as the existence of initials or signatures.
  - Inspection of XYZ Service Organisation's systems documentation, such as operations, manuals, flow charts and job descriptions.
3. Observation:
- Observed the application or existence of specific controls as represented.
4. Re-performance:
- Re-performed the control or processing application of the controls to check the accuracy of their operation. This included, among other things:
    - Obtaining evidence of the arithmetical accuracy and correct processing of transactions by performing independent calculations.
    - Re-performing the matching of various system records by independently matching the same records and comparing reconciling items to reconciliations prepared by XYZ Service Organisation.

## **Appendix 6**

(Ref: Para.)

### **ILLUSTRATIONS OF SERVICE AUDITOR'S REPORTS ON FINANCIAL INFORMATION**

The following example Service Auditor's Reports are for use as a guide only, in conjunction with the considerations described in GS 007, and will need to be varied according to individual requirements and circumstances.

#### **Example 1: Service Auditor's Report on Specified Assertions**

##### **INDEPENDENT AUDITOR'S REPORT**

To [those charged with governance] of XYZ Service Organisation regarding [user entity]

##### **Report on Specified Assertions of Assets [and liabilities or transactions] in the Statement<sup>135</sup>**

We have audited the [specify assertions audited: for transactions or events: occurrence, completeness, accuracy, cut-off and classification; for balances: existence, rights and obligations, completeness or valuation and allocation; or for presentation and disclosure: occurrence, rights and obligations, completeness, classification and understandability and accuracy and valuation] of the assets [and liabilities or transactions] of the accompanying [title of financial statement] ("the Statement"), which comprises the [statement of assets and liabilities] as at [date], and the [statement of transactions] for the year then ended, concerning the assets [and liabilities or transactions] of [user entity]<sup>136</sup> for which XYZ Service Organisation provides [specify investment management service provided: custody, asset management, property management, superannuation member administration, investment administration or registry] services, set out on pages [ ] to [ ]<sup>137</sup>.

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<sup>135</sup> The subheading "Report on the Statement" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>136</sup> Where the assets are held in the name of a nominee holding company insert "held in the name of [nominee holding company]".

<sup>137</sup> When the auditor is aware that the Statement will be included in a document that contains other information, the auditor may consider, if the form of the presentation allows, identifying the page numbers on which the Statement is presented.

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Appendix 6, Example 1

The Statement has been prepared on the basis on accounting described in note X.

**Management’s Responsibility for the Statement**

XYZ Service Organisation is responsible for [investment management services] on behalf of [user entity]. Management is responsible for the preparation and fair presentation of the Statement in accordance with [specify framework applied]<sup>138</sup> and have determined that the accounting policies described in Note X to the Statement are appropriate to meet the financial reporting requirements of the [title of contract or service level agreement] and are appropriate to meet the needs of [user entity]. Management are also responsible for such internal control as management determines is necessary to enable the preparation of the Statement that is free from material misstatement, whether due to fraud or error..

**Auditor’s Responsibility**

Our responsibility is to express an opinion on the [specify assertions audited] in respect of the assets [and liabilities or transactions] in the accompanying Statement, based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those Standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the assets [and liabilities or transactions] set out in the Statement are free of material misstatement in respect of the specified audit assertions.

An audit of [specify assertions audited] of the assets [and liabilities or transactions] in the Statement involves performing procedures to obtain audit evidence that the assets [and liabilities or transactions] set out in the Statement [insert relevant assertion: for example for existence insert “exist as at [date]” or for valuation insert: “have been appropriately valued in

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<sup>138</sup> Insert “applicable Australian Accounting Standards” where multiple Australian Accounting Standards were applied; insert reference to specific Australian Accounting Standard where appropriate (for example: “in accordance with the measurement standards of AAS 25 *Financial Reporting by Superannuation Plans.*”); or “the accounting policies described in Note X to the Statement”.

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Appendix 6, Example 1

accordance with [specify framework]”<sup>139</sup>. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the Statement in relation to the specified assertions, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to XYZ Service Organisation’s preparation and fair presentation of the Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Service Organisation’s controls<sup>140</sup>. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by management with respect to the specified assertions.

We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion.

[Insert either: No uncorrected misstatements, other than amounts which are clearly trivial, have been identified during the course of our audit; Or: uncorrected misstatements, other than amounts which are clearly trivial, which, have come to our attention during the course of our audit and are not material individually or in aggregate in relation to the [specify assertions audited] in respect of the assets [and liabilities or transactions] in the accompanying Statement but may be material when aggregated with any uncorrected misstatements identified by [user entity]’s Auditor, are listed in an attachment to this report. These uncorrected misstatements do not affect our audit opinion.]

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<sup>139</sup> Insert “applicable Australian Accounting Standards” where multiple Australian Accounting Standards were applied; insert reference to specific Australian Accounting Standard where appropriate (for example: “in accordance with the measurement standards of AAS 25 *Financial Reporting by Superannuation Plans.*”) or “the accounting policies described in Note X to the Statement”.

<sup>140</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the Statement, this sentence would be worded as follows: “In making those risk assessments, the auditor considers internal control relevant to XYZ Service Organisation’s preparation and fair presentation of the Statement in order to design audit procedures that are appropriate in the circumstances.”

**Guidance Statement GS 007 Audit Implications of the Use of Service Organisations for Investment Management Services**

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Appendix 6, Example 1

**Opinion**

In our opinion, the Statement presents fairly, in all material respects, the [specify assertions audited] of the assets [and liabilities or transactions] of [user entity], for which XYZ Service Organisation] provides [investment management service] services, as of [date] in accordance with [specify framework]<sup>141</sup>.

**Basis of Accounting and Restriction on Distribution**

Without modifying our opinion, we draw attention to Note X to the Statement, which describes the basis of accounting. The Statement has been prepared by XYZ Service Organisation for distribution to the [the Trustee/those charged with governance] of [user entity]. Our report is intended solely for XYZ Service Organisation, [user entity] and their auditor and should not be distributed to any other parties or used for any other purpose other than that for which they are prepared.<sup>142</sup>

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities].

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

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<sup>141</sup> Insert "applicable Australian Accounting Standards" where multiple Australian Accounting Standards were applied; insert reference to a specific Australian Accounting Standard where appropriate (for example: "the measurement standards of AAS 25 Financial Reporting by Superannuation Plans."; or "the accounting policies described in note X to the Statement".

<sup>142</sup> Use of the report & liability limitation: insert additional/alternative wording, if any, required to reflect any liability arrangements agreed between the service auditor, the service organisation and other users, including confirmation of the purpose for which the service auditor's report has been prepared and the basis on which other parties may use the report.

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Appendix 6, Example 1

**[Attachment: Uncorrected Misstatements]<sup>143</sup>**

In the course of conducting our audit procedures at XYZ Service Organisation] for the purpose of reporting on [specific assertions] we have identified the following uncorrected misstatements, other than amounts which are clearly trivial, which were determined by [management/those charged with governance] to be immaterial, both individually and in aggregate, to the [specific assets and liabilities or transactions] taken as a whole. These misstatements are reported solely for the purpose of providing information to customers of XYZ Service Organisation] and their auditors and they do not affect our audit opinion:

**[Insert: List of uncorrected misstatements]**

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<sup>143</sup> Include attachment where uncorrected misstatements were identified.

## **Example 2: Service Auditor’s Report on a Statement**

### **INDEPENDENT AUDITOR’S REPORT**

To [those charged with governance] of XYZ Service Organisation regarding [user entity]

#### **Report on the Statement<sup>144</sup>**

We have audited the accompanying [title of financial statement] ("the Statement"),<sup>145</sup> which comprises of the [statement of assets and liabilities] as at [date], and the [statement of transactions] for the year then ended, concerning the assets [and liabilities or transactions] of [user entity]<sup>146</sup> for which XYZ Service Organisation] provides [specify investment management services provided: custody, asset management, property management, superannuation member administration, investment administration or registry] services set out on pages [ ] to [ ]<sup>147</sup>. The Statement has been prepared on the basis of accounting described in note X.

#### **Management’s<sup>148</sup> Responsibility for the Statement**

XYZ Service Organisation is responsible for [investment management services] on behalf of [user entity]. Management is responsible for the preparation and fair presentation of the Statement in accordance with [specify

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<sup>144</sup> The subheading “Report on the Statement” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.

<sup>145</sup> If certain assertions are specifically excluded from the audit then insert: “except for [specify assertions excluded, e.g. presentation & disclosure] of the statement.”

<sup>146</sup> Where the assets are held in the name of a nominee holding company insert “held in the name of [nominee holding company].”

<sup>147</sup> When the auditor is aware that the Statement will be included in a document that contains other information, the auditor may consider, if the form of the presentation allows, identifying the page numbers on which the Statement is presented.

<sup>148</sup> Insert the title of those charged with governance – e.g. directors/trustees/committees. For example, “Director’s Responsibility for the Statement”. Insert appropriate title, when prompted, throughout the report.

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framework]<sup>149</sup> and have determined that the accounting policies described in Note X to the Statement are appropriate to meet the financial reporting requirements of the [title of contract or service level agreement] and are appropriate to meet the needs of [user entity]. Management are also responsible for such internal control as management determines is necessary to enable the preparation of the Statement that is free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**

Our responsibility is to express an opinion on the Statement based on our audit. No opinion is expressed as to whether the accounting policies used, as described in Note X, are appropriate to meet the needs of [user entity]. We conducted our audit in accordance with Australian Auditing Standards. Those Standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Statement is free from material misstatement.

An audit of the Statement involves performing procedures to obtain audit evidence about the amounts and disclosures in the Statement. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to XYZ Service Organisation's preparation and fair presentation of the Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Service Organisation's controls<sup>150</sup>. An audit also includes evaluating the appropriateness of accounting policies used

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<sup>149</sup> Insert "applicable Australian Accounting Standards" where multiple Australian Accounting Standards were applied; insert reference to specific Australian Accounting Standard where appropriate (for example: "in accordance with the measurement standards of AAS 25 *Financial Reporting by Superannuation Plans.*") or "the accounting policies described in Note X to the Statement".

<sup>150</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the Statement, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to [name of service organisation]'s preparation and fair presentation of the Statement in order to design audit procedures that are appropriate in the circumstances."

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and the reasonableness of accounting estimates, if any, made by management, as well as evaluating the overall presentation of the Statement.

We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion.

[Insert either: No uncorrected misstatements, other than amounts which are clearly trivial, have been identified during the course of our audit; Or: uncorrected misstatements, other than amounts which are clearly trivial, which, have come to our attention during the course of our audit and are not material individually or in aggregate in relation to the Statement but may be material when aggregated with any uncorrected misstatements identified by [user entity]'s Auditor, are listed in an attachment to this report. These uncorrected misstatements do not affect our audit opinion.]

**Opinion**

In our opinion, the attached Statement presents fairly, in all material respects, the assets [and liabilities] of [user entity] as of [date] and transactions for the [period] then ended, for which XYZ Service Organisation] provides [investment management service] services, in accordance with in accordance with the basis of accounting described in Note X..<sup>151</sup>

**Basis of Accounting and Restriction on Distribution**

Without modifying our opinion, we draw attention to Note X to the Statement, which describes the basis of accounting. The Statement has been prepared by XYZ Service Organisation for distribution to the [the Trustee/those charged with governance] of [user entity]. As a result, the schedule may not be suitable for another purpose. Our report is intended solely for XYZ Service Organisation, [user entity] and their auditor and

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<sup>151</sup> Insert “applicable Australian Accounting Standards” where multiple Australian Accounting Standards were applied; insert reference to a specific Australian Accounting Standard where appropriate (for example: “the measurement standards of AAS 25 Financial Reporting by Superannuation Plans.”); or “the accounting policies described in Note X to the Statement”.

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should not be distributed to any other parties or used for any other purpose other than that for which they are prepared.<sup>152</sup>

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities].

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

**[Attachment:Uncorrected Misstatements]<sup>153</sup>**

In the course of conducting our audit procedures at XYZ Service Organisation] for the purpose of reporting on [the Statement] we have identified the following uncorrected misstatements, other than amounts which are clearly trivial, which were determined by [management/those charged with governance] to be immaterial, both individually and in aggregate, to the [specific assets and liabilities or transactions/Statement] taken as a whole. These misstatements are reported solely for the purpose of providing information to customers of XYZ Service Organisation and their auditors and they do not affect our audit opinion:

[Insert: List of uncorrected misstatements]

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<sup>152</sup> Use of the report & liability limitation: insert additional/alternative wording, if any, required to reflect any liability arrangements agreed between the service auditor, the service organisation and other users, including confirmation of the purpose for which the service auditor's report has been prepared and the basis on which other parties may use the report.

<sup>153</sup> Include attachment where uncorrected misstatements were identified.