

The Chairman
Auditing and Assurance Standards Board
PO Box 204
Collins Street West
Melbourne Victoria 8007

4 February 2011

Dear Ms Kelsall,

Re: GS 007 Feedback

We appreciate the opportunity to comment on GS 007 *Audit Implications of the Use of Service Organisations for Investment Management Services* as issued by the Australian Auditing and Assurance Standards Board ("AUASB") in March 2008, and its use by service and user entities and auditors since that date.

Our response contains three sections. Section one contains our overall comments in relation to GS 007 and its implementation. In Section two we set out our specific response in relation to your request for comments. Section three contains additional observations for your consideration when updating GS 007 during 2011.

1) Overall comments

In our view, the introduction of GS 007 has succeeded in providing greater transparency of the work performed by service auditors, and improved the overall scope and consistency of controls reporting.

From a user entity perspective, we believe that GS007 has given those charged with governance a better level of understanding of the controls, and ability to assess, their outsourced functions and activities.

2) Specific areas on which the AUASB is seeking a response

- 1) *The extent to which investment management service organisations are obtaining service auditor's reports under GS 007; and*

The extent to which user entities or user auditors are requesting those reports.

User Entities

Trustees of superannuation funds are in our experience, actively requesting GS 007 from their outsourced service providers. This has perhaps been driven by the widespread use of outsourcing in the superannuation industry and specific focus on and guidance on outsourcing by APRA. Other highly engaged industry participants (other than auditors) include Responsible Entities of Managed Investment Schemes, however our experience suggests that hedge fund managers are less likely to receive reports on controls at their service providers e.g. prime brokers.

Historically there have been differences between GS 007 and international equivalent reports (e.g. SAS 70 reports from the US). We acknowledge that the implementation of ISAE 3402 *Assurance Reports on Controls at a Service Organisation* and its local equivalents should remove several of the differences.

In cases where the outsourced provider is a related party, such as in the retail superannuation sector, we see significantly fewer GS 007 internal control reports being prepared and provided to user entities and/or auditors.

User Auditors

User auditors are requesting GS 007 internal control reports for their audits, particularly in relation to superannuation funds, managed investment schemes and related compliance audits. Where an external custodian, investment administrator, registry provider or superannuation administrator is used the auditor will generally **require** a Type 2 controls report over the services provided. Where external Asset Management (as defined in GS 007 Appendix 2, Section B) services are provided, the provision of a controls report is not an audit requirement, however provision of these reports assists the auditor in obtaining sufficient and appropriate audit evidence.

In many cases, special purpose reports over the existence, rights & obligations, and valuation of pooled fund assets held by a custodian are an important part of the audit process.

- 2) *Are service auditors' reports with respect to investment management service organisations providing the audit evidence user auditors require for the audit of user entities' financial reports?*

Service auditor reports assist the fund auditor in obtaining sufficient and appropriate audit evidence. GS 007 reports generally satisfy the requirements of fund auditors, however there are areas which could be improved. Refer comments above as well as areas for some suggested areas for improvement listed below.

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

Our feedback is as follows:

- Definition of 'Outsourced Activities' – does this include all service providers, or only 'material' outsourced service providers? More guidance would be welcome.
- Objectives that include the wording "on a timely basis" or "in a timely manner" are more open to discretion and judgement on the part of the user auditor than other objectives. This does not enhance comparability of reports and it can be difficult for the user auditor to form an opinion on what is "timely". We suggest that the inclusion of such terms in objectives be examined.
- Control objective 'Segregation of Duties' – this can be regarded as a control to support other objectives, rather than an objective in itself.
- We would like to see specific, standardised Unit Pricing control objectives which may include policy, accuracy of calculations, discretionary inputs, quality assurance and tax accounting.
- The 'Asset Management' objectives cater well for mandate business, but are less suited for entities who only offer Pooled Funds, for example via a 'manage the manager' business model. There are difficulties around the definition of who the 'client' is, and the objectives do not specifically cover some of the risks implicit in this business model (e.g. manager transitions and monitoring).
- The IT Objectives contained in GS 007 are sufficiently broad to enable service entities to consider a number of underlying risks. However, we believe that certain emerging IT risks (for example cloud computing) warrant highlighting in the revised GS 007.

- 4) *Do the six services addressed by GS 007 cover the investment management services which may be part of the user entity's information system, including business processes, relevant to financial reporting?*

Yes, when properly applied.

3) Other observations

Scope of GS 007

The scope of GS 007 is wide and includes guidance for:

- Special purpose reports;
- Reports on internal control;
- Service entities and auditors; and
- User entities and auditors.

We welcome the AUASB's move to update GS 007 in the light of ASAE 3402, clarity standards and other feedback received, and note that there is an opportunity to remove duplications with existing stand-alone standards for both service and user auditors. It would be preferable if GS 007 focused on industry-specific guidance, with references to other standards and guidance as applicable. We would also encourage a debate as to whether GS 007 should focus solely on internal controls reporting, with special purpose reports being the subject of separate standards.

When and how to qualify assurance reports:

Additional guidance regarding the assessment of exceptions noted, and the impact on the assurance report as a whole, would be beneficial.

Inclusive vs. Exclusive method

Most of our clients, and the industry in general, adopt the Exclusive method rather than the Inclusive method. The acceptability of a 'middle ground' whereby controls to monitor subservice organisations are included in the report is not explicitly clear in GS 007, however we believe such controls should be included in reports prepared under the Exclusive method. ASAE 3402 is clearer on the need for monitoring controls, which may address this issue when GS 007 is updated.

We would be pleased to discuss our comments with members of the Board or its staff. If you wish to do so, please do not hesitate to contact me on 02 9322 5250.

Yours sincerely



DELOITTE TOUCHE TOHMATSU



Andy Young
Partner

