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Ref: DAH/TJB/BJB

Ms Merran Kelsall  
Chairman  
Australian Auditing and Assurance Standards Board

By email: [enquiries@auasb.gov.au](mailto:enquiries@auasb.gov.au)

11 February 2011

Dear Ms Kelsall

## **Request for comment on GS007 Audit Implications of the Use of Service Organisations for Investment Management Services**

We refer to your request for comment on practitioners' experiences in implementing GS007 as posted on the AUASB website and have provided our comments herewith.

The GS007 reports that we have received from investment fund managers operated by the major banks report a number of errors in the samples used to test control objectives. Consequently they provide little comfort beyond the fact that issues identified have been remedied or investigated, presumably at sometime prior to release of the GS007 report to enable inclusion of a comment to that effect.

Our primary audit evidence is obtained through examination of internal controls at the user entity over managed investments. Statements received from the service provider can then be compared to internal records maintained by the client, in much the same way as an organisation would maintain bank records and prepare bank reconciliations. The GS007 is seen as something that is perhaps 'nice to have' but does not make a significant contribution to our audit evidence as we conduct significant work around our clients' monitoring, reconciliation and supervision of work carried out by service providers. In addition the cost to obtain these reports may be quite significant for smaller fund managers.

Our responses to specific requests for comment, based on our experience are provided below:

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.**
  - Generally, a request for a GS007 Type B Controls Report is made to the investment management service organisation by the user entity. A Type A Controls Report cannot be relied upon to reduce substantive procedures, therefore user auditors need to obtain Type B Controls Report.
  - However, in contrast to the prudential reporting requirements imposed by APRA (in the case of a bank or deposit account) there are no mandatory obligations that require a service organisation to prepare a GS007 report in respect of controls over its investment management services. Consequently, requests to investment management service organisations for a GS007 Type B Controls Report are not always fulfilled. Internal Control Reports may be provided in place of GS007 and therefore the user auditors may need to conduct alternative procedures to address perceived gaps, as indicated by control objectives outlined in GS007.
  - The Type B Controls Report are often received around 30-45 days post period end. With lodgement of preliminary results with the ASX required by 31 August (or often earlier for a merge of investment schemes to meet unitholder information expectations), if gaps are identified in the Type B Controls Report, there is insufficient time to obtain further assurance reports prior to the release of preliminary results to the ASX, and release of the final statutory financial reports by 30 September. Therefore in our experience it is uncommon that a Special Purpose Service Auditor's Report would be obtained in respect of material balances or classes of transactions due to the tight timeframe in which the report would need to be issued and the additional cost to the client.
  - Audit procedures still need to be performed by the user auditors at the user entity, in respect of the assertions for the same balances for which the GS007 Type B Controls Report provides assurance regarding the operating effectiveness of internal controls. Consequently, in our view, a standard confirmation (in similar format to a bank confirmation) is likely to provide sufficient audit evidence for reports issued by the service organisation to the client (ie. fair value investments, dividend income, profit/loss on sale of investments), along with a GS007 Type A Controls Report.
  
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?**
  - We have not been able to reduce the extent of audit testing at the user entity as a consequence of receiving a GS007 Type B Controls Report. We gain primary audit evidence by testing the internal control procedures implemented by the user entity over the monitoring, supervision and reconciliation processes as the GS007 reports received to date do not provide audit evidence on which we would rely.

- We seek to ensure that the control objectives needed to provide audit evidence to support audit assertions are met by the service organisation. The GS007 Type B Controls Report allows the effectiveness of internal control procedures at the service organisation to be reported. However, there is minimal disclosure within a Type B Controls Report regarding assessment of the investment management service organisation's inherent risks and internal control environment. Therefore the user organisation cannot make their own assessment as to whether the extent of testing performed is appropriate to identify any weakness in controls.
- Further the Type B Controls Reports received frequently report errors in the control testing performed and are delivered too late to request further work to be carried out by the service entity auditor within the timeframe for reporting by the user entity.
- Due to modifications of the GS007 audit report issued by investment management services organisation auditors, even if no errors were reported, user auditors would not be able to place reliance on their audit reports.

*An example:*

“ It is the responsibility of each client’s external auditor to obtain sufficient appropriate audit evidence to support their audit opinion on the clients portfolios....We do not accept or assume liability to anyone other than the Management of Asset Servicing and ‘*The service organisation*’ for our work, our report or for the conclusions we have formed.”

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.**
  - The control objectives are comprehensive, relevant and clear for each service area.
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?**
  - The 6 services addressed by GS007 cover the investment management services which may be part of the user entity’s information system.

Yours sincerely



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Partner



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