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International Auditing and Assurance Standards Board
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JICPA Comments on the Proposed International Standard on Assurance Engagements, ISAE
3402, *Assurance Reports on Controls at a Third Party Service Organization*.

The Japanese Institute of Certified Public Accountants (“we”, “our”, “us” and “JICPA”) is pleased to provide you with our comments on the Proposed International Standard on Assurance Engagements, ISAE 3402, *Assurance Reports on Controls at a Third Party Service Organization* (“Proposed ISAE 3402”). Based on our review, we have the following comments:

Request for Specific Comments

1. Assertion-based Engagements

We agree with the proposal that the ISAE be written for application to assertion-based engagements.

2. Link with International Standards on Auditing (ISAs)

We agree with the proposal to include relevant requirements based on ISAs. Theoretically, general requirements that are likely to be relevant in all assurance engagements should be included in ISAE 3000, and ISAE 3402 only include special consideration regarding the assurance engagement on controls at a service organization. However, at this stage, it is not appropriate to revise ISAE 3000 in consideration of ISAE 3402 only. Unless there is an urgent need, the revision of ISAE 3000 should be treated as a specific future project which would also include the consideration of consistency to other new ISAE projects and the application of the clarity drafting convention.

3. Auditor’s External Experts

As per our comment on 2 above, it should be dealt in the future project to revise ISAE 3000.

4. Suitable Criteria

Please see our “Other Comments” below.

5. Disclosure of Sample Sizes

To be consistent with current practice in most jurisdictions, the description of tests of controls included in a Type B report should include the disclosure of sample sizes determined by the service auditor only when a deviation from controls is found.

The service auditor determines a sample size based on its own audit methodology. The user auditor, however, does not know all the information that the service auditor used to determine the sample size. Therefore, by disclosing sample sizes, the user auditor may get a wrong impression about the work performed by the service auditor. In addition, unless deviations have been identified, disclosure of sample sizes is not likely to provide useful information to the user auditor.

Other Comments

Paragraph 1 first sentence and paragraph 2(a)

Since the description of the service organization’s system may also include aspects of one or more of the other components of internal control other than information system (see paragraph A1), we propose the following revision:

(Paragraph 1 first sentence)

“This International Standard on Assurance Engagements (ISAE) deals with reasonable assurance engagements undertaken by a professional accountant to report on the controls at a third party organization that provides a service to user entities *that* ~~when those controls are~~ likely to be part of user entities’ information systems relevant to financial reporting.”

(Paragraph 2(a))

“Controls at a service organization ~~other than those that are~~ *not* likely to be ~~part of user entities’~~ ~~information systems~~ relevant to financial reporting *by user entities* (for example, controls that affect user entities’ regulatory compliance, production or quality control)...”

Paragraph 9(m) second sentence

In the case of a Type A report, the description of the service organization’s system is “at the date”. Therefore, we propose the following revision:

“The description of the system prepared by management of the service organization includes identification the services covered, the *date or* period to which the description relates, control objectives and related controls.”

Paragraph 9(p)

Since “report on the financial statements” is subsumed in “audit” (see paragraph 5 of proposed

ISA 200 (Revised and Redrafted), we propose the following revision:

“An auditor who audits ~~and reports on~~ the financial statements of a user entity.”

Paragraph 12(a)(ii)

In some cases, depending on the circumstances, the acceptance of an engagement should be permitted even if the service auditor will not have access to sufficient appropriate evidence. Also, the context of paragraph 12(a)(ii) seems to be substantially covered by paragraph 12 (b)(v). Therefore, paragraph 12(a)(ii) should be deleted and the requirement which is similar to paragraph 5 of proposed ISA210 (Redrafted) (*) should be added.

((*): Paragraph 5 of proposed ISA 210 (Redrafted))

“If management or those charged with governance impose a limitation on the scope of the auditor’s work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.”

Paragraph 12(b)(iii) and paragraph 56 (g)(iii)

It is not clear to us to whether there is intended difference between the meaning of the phrases “stating the control objectives” and “specifying the control objectives” (see paragraph 56(d)). To clarify that the control objectives are always included in the description of the service organization’s system (see paragraph 9(m)), “specifying the control objectives” should be used.

Paragraph 15(a)(vi)

Since (i) to (v) and (vii) describe the components of internal control (“controls”), such as information system, it is not logical to include (vi) in paragraph 15(a). Also, it is obvious from a written assertion by the service organization’s management that control objectives and related controls are stated in the description of the service organization’s system (see paragraph 9(i)(ii)b and (j)(ii)b. and c.). Therefore, paragraph 15(a)(vi) should be deleted.

Paragraph 34

Since the term “confirm” might be confused with “external confirmation procedure”, the first sentence should be changed to be consistent with paragraph 13 of ISA 315 (Redrafted). The second sentence might result in the wrong interpretation that, in addition to inquiries, both observation and inspection of records and other documentation should be always performed. To be consistent with paragraphs 13 and A63 of ISA 315 (Redrafted), the second sentence should be moved to “Application and Other Explanatory Material”:

(Paragraph 34)

“The service auditor shall determine whether the service organization’s system had been implemented by performing procedures in addition to ~~confirm the implementation of the service organization’s system through other procedures in combination with~~ inquiries of management and other service organization personnel. ~~Those other procedures shall include observation, and~~

inspection of records and other documentation, of the manner in which transactions are processed through the system and controls are applied”

(Paragraph A15 (new))

“Procedures to determine whether the service organization’s system had been implemented may include observation, and inspection of records and other documentation, of the manner in which transactions are processed through the system and controls are applied.”

Paragraph 38

The consideration of the nature of controls, the frequency of their application, and the expected rate of deviation, which is not included in “Requirements” in proposed ISA 530 (Redrafted) (see paragraph 6 of proposed ISA 530 (Redrafted)), should be moved to “Application and Other Explanatory Material”, since it is too procedural in nature.

Paragraph 42

To be consistent with ISA 580 (Revised and Redrafted) which was approved in December 2007, we propose the following revision:

“The service auditor shall request management or those charged with governance to provide written representations ~~based on their knowledge and belief, having made appropriate inquiries for them to be able to provide such representations~~ *that*:

- (a) ~~They~~ *That* reaffirm the assertion accompanying the description of the system;
- (b) ~~Whether~~ *All* records...
- (c) ~~That~~ *They* have disclose...”

Paragraph 56(1)

To be consistent with paragraph 39 of proposed ISA 700 (Redrafted), we propose the following revision:

“The name of the service auditor, and the *location in the country or jurisdiction where the service auditor practices* ~~city where the service auditor maintains the office that has responsibility for the engagement.~~”

Paragraph A14

The use of the phrase “it is important...” should be limited in the clarified ISAs since the distinction with “Requirements” is not clear. If the inclusive method has been used, the evaluation of whether the description adequately differentiates between controls at the service organization and controls at the subservice organization is required in all cases. Therefore, the first sentence should be moved to “Requirements”:

(Paragraph 33)

“...(d) Services performed by a subservice organization, if any, are adequately described, including whether the inclusive method or the carve-out method has been used in relation to them.

(e) If the inclusive method has been used, the description adequately differentiates between controls at the service organization and controls at the subservice organization.”

(Paragraph A14)

~~“If the inclusive method has been used, it is important that the description adequately differentiates between controls at the service organization and controls at the subservice organization. If the carve-out method is used, it is important that the description identifies the functions that are performed by the subservice organization, but it need not describe the detailed processing or controls at the subservice organization.”~~

Paragraph A22

Paragraph A22 states “evidence from prior engagements about the satisfactory operation of controls in prior periods cannot provide a basis for a reduction in testing”. We believe that the service auditor should be permitted to use the knowledge from the tests of controls in prior periods as input to the planning of the tests of controls in the current period. For example, if the effectiveness of the automated control was tested in the prior period engagement, and the other controls, such as the control over program changes, has been tested in the current period, the service auditor may reduce the sample size of the automated control. Therefore, we propose the following revision:

“Auditor cannot assess effectiveness of the control only from evidence about the effectiveness of such control obtained in prior engagements. Evidence from prior engagements about the satisfactory operation of controls in prior periods cannot provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period. This is because the service auditor provides an opinion on the effectiveness of controls throughout each period, therefore sufficient evidence about the operation of controls during the current period is required for the service auditor to express that opinion.”

In closing, we wish to express our appreciation for this opportunity to comment on this Proposed International Standard on Auditing and hope you will consider our comments.

Sincerely yours

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Executive Board Member - Auditing Standards

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