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## Media Center

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## IAASB Proposes New Standards on Service Organizations and Communicating Deficiencies in Internal Control; Makes Further Progress on Clarity of Standards

(New York/December 21, 2007) - At its recent meeting in Washington, D.C., the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board under the auspices of the International Federation of Accountants (IFAC), approved three new proposed standards: two focus on enhancing the auditors' consideration of controls at service organizations, and the third addresses the communication of deficiencies in internal control to those charged with

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governance. These standards reflect the importance of internal control within audited entities and at their service organizations, and of the auditor's responsibility to make significant findings available to those charged with governance. The IAASB is also releasing two exposure drafts written in accordance with the new clarity drafting conventions.

### Third Party Service Organizations

Many entities outsource aspects of their businesses to organizations that provide services ranging from performing a specific task under the direction of the entity to replacing one or more of the entity's business units or functions. Frequently, services provided by such organizations are integral to the entity's information system relevant to financial reporting.

Following a risk-based approach, proposed International Standard on Auditing (ISA) 402 (Revised and Redrafted), *Audit Considerations Relating to an Entity Using a Third Party Service Organization*, deals with the auditor's responsibilities to obtain audit evidence when an entity uses one or more service organizations. This may include

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obtaining reports prepared by the auditors of those organizations.

Proposed International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Third Party Service Organization*, is the first subject matter-specific standard developed under the IAASB's *International Framework for Assurance Engagements*. It complements proposed ISA 402 (Revised and Redrafted) in that reports prepared in accordance with proposed ISAE 3402 will be capable of providing appropriate audit evidence under the proposed ISA. It will help to bring consistency in reporting on controls at service organizations, thereby assisting such organizations to meet the needs of clients ("user entities") and their auditors. In particular, it should ensure that reports issued in one country are likely to meet the requirements of the auditors of user entities in other countries.

"The proposed standards reflect the IAASB's recognition of the increasing use of service organizations worldwide. In revising our existing standard for the auditors of user entities, and complementing it with a new standard for the auditors of service organizations, we are

proposing consistent and comprehensive guidance for this important aspect of auditing,” says John Kellas, Chairman of the IAASB.

### **Communicating Deficiencies in Internal Control**

The IAASB also seeks comments on proposed ISA 265, *Communicating Deficiencies in Internal Control*. This deals with the auditor’s responsibility to communicate to management and those charged with governance deficiencies in internal control that have been identified by the auditor. It distinguishes between significant and other deficiencies in order to establish requirements to communicate to the appropriate levels within the audited entity. It also requires the former to be communicated in writing to those charged with governance.

“This new proposed standard is intended to enhance the effectiveness of the auditor’s communication of deficiencies in internal control by requiring a clearer focus on what is important to those taking ultimate responsibility for control over financial reporting. The proposed standard will require these matters to be communicated in writing, and on a timely basis so that those charged with governance can

take steps to strengthen internal control," explains Mr. Kellas.

### **New Clarity Exposure Drafts**

The IAASB has also approved the following exposure drafts of proposed ISAs:

- ISA 501 (Redrafted), *Audit Evidence Regarding Specific Financial Statement Account Balances and Disclosures*; and
- ISA 520 (Redrafted), *Analytical Procedures*.

These exposure drafts form part of the IAASB's ambitious 18-month program to redraft existing standards and to develop new and revised standards following the new clarity drafting conventions. Subject to any comments on exposure, the final standards will become effective for audits of financial statements for periods beginning on or after December 15, 2009.

### **How to Comment**

Comments on the exposure drafts are requested as follows:

- Proposed redrafted ISAs 501 and 520 by March 31, 2008;
- Proposed ISA 402 (Revised and Redrafted) and proposed ISA 265 by April 31, 2008; and

- Proposed ISAE 3402 by May 31, 2008.

The exposure drafts may be viewed by going to <http://www.ifac.org/EDs>. Comments may be submitted by email to [EDComments@ifac.org](mailto:EDComments@ifac.org). They can also be faxed to the attention of the Executive Director, Professional Standards at +1 (212) 286-9570 or mailed to IFAC, 545 Fifth Avenue, 14th Floor, New York, NY 10017, USA. All comments will be considered a matter of public record and will ultimately be posted on IFAC's website.

### **About the IAASB and IFAC**

The objective of the IAASB is to serve the public interest by setting high quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. The Public Interest Oversight Board oversees the activities of the IAASB and, as one element of that oversight, establishes its due process and working procedures.

Founded in 1977, IFAC is the global organization for the accountancy profession

dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of 158 members and associates in 123 countries and jurisdictions, representing more than 2.5 million accountants in public practice, education, government service, industry and commerce. In addition to setting international auditing and assurance standards through the IAASB, IFAC, through its independent standard-setting boards, sets international ethics, education, and public sector accounting standards. It also issues guidance to encourage high quality performance by professional accountants in business.

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