



AUDIT &
ASSURANCE
FACULTY

TECHNICAL RELEASE

re:Assurance

A FRAMEWORK FOR ASSURANCE REPORTS ON THIRD PARTY OPERATIONS

Technical Release AAF 02/07



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AAF 02/07 is issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) in November 2007. AAF 02/07 gives guidance on providing assurance services on different aspects of business relationships between two or more parties. AAF 02/07 does not constitute an auditing or assurance standard. Professional judgement should be used in its application, and where appropriate, professional legal assistance should be sought.

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About AAF 02/07

AAF 02/07 is intended to provide high-level yet practical guidance for practitioners who provide assurance services on operations or arrangements agreed between two or more organisations (third party operations). AAF 02/07 provides an overarching framework for assurance engagements on third party operations where specific guidance (e.g. AAF 01/06 and ITF 01/07) does not exist. Its principles are consistent with AAF 01/06 and ITF 01/07.

Whilst the technical release alerts readers to areas where potential risks of duty of care exist, readers refer to AAF 04/06 for detailed guidance.

INTRODUCTION

Preface

1 AAF 02/07 *A framework for assurance reports on third party operations* sets out a framework for performing assurance engagements on various aspects of business relations that are undertaken between organisations¹. AAF 02/07 provides definitions and objectives of this type of assurance engagement and sets out engagement procedures to promote consistency in the performance of an assurance engagement in line with pronouncements published by the International Auditing and Assurance Standards Board (IAASB) of which the ICAEW is a member.

Assurance on third party operations

- 2 Many user organisations rely on services provided by, or have relationships with, other parties (each such third party is referred to as 'a responsible party')². User organisations may:
- outsource functions or parts of their business operations;
 - contract with suppliers, customers and service providers for specific activities, use of intellectual property or other items; or
 - undertake joint ventures, licensing or other shared arrangements
 - in often complex arrangements usually governed by contractual commitments.
- 3 User organisations and responsible parties are increasingly seeking assurance on various aspects of the operations performed by responsible parties for user organisations. User organisations may wish to be confident, for example, that they are receiving the service as agreed or paying the appropriate fee for the rights received. In contrast, responsible parties may wish to demonstrate that they are performing tasks as agreed with user organisations. This technical release refers to the aspects of operations that responsible parties provide and may be subject to external examinations as third party operations.
- 4 Professional accountants in public practice (practitioners) can help increase the confidence of either responsible party or user organisations in their relationships by performing a number of professional services; namely assurance engagements, agreed-upon procedures and investigative work. Agreed-upon procedures and investigative work generally do not result in an independent conclusion conveying assurance. Such engagements may bear similarities to assurance engagements, but their purpose, scope and form of reporting are different: in particular, non-assurance reports typically provide factual findings rather than an independent conclusion conveying assurance.

For the Audit and Assurance
Faculty Technical Releases, see
www.icaew.com/technicalreleases

¹ Where reporting on regulated entities, the practitioner may wish to refer to the guidance given in the Audit and Assurance Faculty AUDIT 05/03 *Reporting to Regulators of Regulated Entities*.

² The specific terminology used in AAF 02/07, such as "the responsible party" and "the subject matter", is based on the pronouncements published by the IAASB: *International Framework for Assurance Engagements* ('the IAASB Assurance Framework') and ISAE 3000, *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*. The term 'user organisations' is used in place of 'intended users' in this guidance. See paragraph 10 for further information on the IAASB pronouncements.

Scope

- 5 AAF 02/07 provides generic guidance to practitioners undertaking an assurance engagement on aspects of third party operations such as transactions, operations, or arrangements (the 'subject matter', see also paragraphs 33–36). It is intended to provide high-level guidance for practitioners who provide assurance services on third party operations where other detailed guidance does not exist³. It is based on the principles set out in the IAASB's pronouncements on assurance engagements as they relate to third party operations (see paragraph 10).
- 6 AAF 02/07 is also expected to assist user organisations in understanding the scope and type of assurance conveyed in the assurance report. It is also aimed at providing assistance to the directors of the responsible party (or their equivalent in other types of organisation) who prepare a report on the subject matter by clarifying their expected responsibilities.
- 7 In an assurance engagement, practitioners express a conclusion designed to enhance the degree of confidence of the intended users of the report (usually other than, but possibly including, the responsible party) over the outcome of the evaluation or measurement of a specific aspect of the operations performed by a responsible party against certain criteria.
- 8 In an agreed-upon procedures engagement, practitioners carry out specific procedures as agreed with the client and other relevant parties as necessary. The report describes the purpose and the agreed-upon procedures of the engagement in sufficient detail to communicate to the addressees the nature and the extent of the work performed. The report lists the specific procedures performed and describes the practitioners' factual findings including description of errors and exceptions found. The report clearly states that the procedures performed do not constitute an assurance engagement and that the report conveys no assurance.
- 9 In other investigative work, practitioners typically carry out such procedures as are proposed by the practitioners and agreed with the client with the objective of proving or disproving a hypothesis, obtaining specified information or providing what facts the practitioners have found during their enquiries. The report describes the objective and results of the work. It may have a conclusion but also it clearly states that the procedures performed do not constitute an assurance engagement and that the report conveys no assurance.

AAF 01/06 *Assurance reports on internal controls of service organisations made available to third parties* and ITF 01/07 *Assurance reports on the outsourced provision of information services and information processing services* are available from www.icaew.com/assurance

International framework

- 10 This guidance follows the framework for assurance engagements set out in the IAASB Assurance Framework and ISAE 3000, published by the IAASB. The IAASB Assurance Framework defines the elements of assurance engagements and describes objectives for such engagements. ISAE 3000 provides generic guidance on the principal aspects of assurance engagements. Together these pronouncements provide high-level principles for assurance engagements other than audits and reviews of historical financial statements.

For the IAASB pronouncements, see www.ifac.org/iaasb

³ Practitioners follow other detailed guidance in relation to the provision of specific third party operations where available. For instance, AAF 01/06 *Assurance reports on internal controls of service organisations made available to third parties* provides guidance to practitioners undertaking an assurance engagement and providing a report in relation to the internal controls of financial services organisations. Similarly ITF 01/07 *Assurance reports on the outsourced provision of information services and information processing services* provides guidance to practitioners undertaking an assurance engagement on internal controls of outsourced IT services and IT processing services. Also see Appendix 2 for example reports.

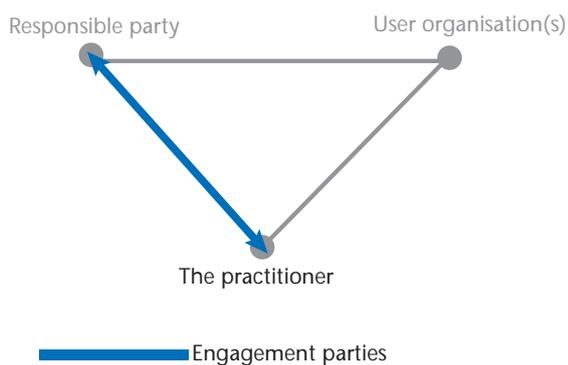
CHARACTERISTICS OF THIRD PARTY OPERATIONS

- 11 The third party operations discussed in this guidance may take a number of different forms. This section describes how assurance engagements over the operations performed by third parties may be structured.
- 12 Relationships between the responsible party and user organisations are usually contractual, but other non-contractual arrangements may exist. Third party operations will typically arise from the outsourcing of user organisations' own activities and the procurement of external services. User organisations may also rely on contractual arrangements with third parties, for example, for the sale of the user organisations' products and services. Other circumstances can also exist, such as joint venture arrangements for the development of a new product for a user organisation or an investor/investee relationship. The nature of the assurance engagement varies accordingly.

Third party operations

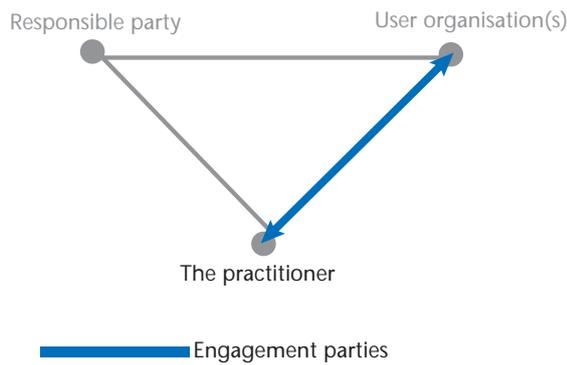
- 13 Assurance engagements over the operations performed by third parties usually take one of two forms (illustrated in figures (a) and (b)).

(a) Engagement with the responsible party



- 14 Figure (a) illustrates a form of engagement where the responsible party engages the practitioner. The practitioner performs an engagement to provide an assurance report over the operations performed by the responsible party. This will typically be with the objective of increasing the confidence of current and possibly prospective user organisations in the responsible party's activities (see paragraph 15). The responsible party usually has contractual obligations to current user organisations and may also be expected to comply with industry or other standards. It also has responsibilities to the practitioner in relation to the performance of the assurance engagement. Examples of these responsibilities and the potential consequences for the practitioner arising from them are set out in paragraph 58.
- 15 In this type of engagement, user organisations may be identified or unidentified, existing or prospective, or combinations of these. Where user organisations are unidentified, the practitioner accepts an assurance engagement only where a typical user organisation is identifiable in the context. This is because, without a reasonably defined user organisation, the practitioner may not be able to specify suitable criteria against which to assess the subject matter. As discussed in paragraph 14, the practitioner considers the issues related to the duty of care as discussed in paragraph and 57.

(b) Engagement with user organisations



- 16 Figure (b) shows an engagement where one or more user organisations (user organisations) contracts with the practitioner to assess the operations of the responsible party with the objective of increasing the user organisations' confidence over the activities of the responsible party. In this type of engagement, the responsible party has contractual (or other) obligations to the user organisations, and the user organisations have responsibilities to the practitioner in relation to the assurance engagement. Examples of these responsibilities and the potential consequences for the practitioner arising from them are set out in paragraph 63.
- 17 This guidance is prepared primarily to cover the circumstances where external user organisations that benefit from an assurance engagement on the subject matter exist or can be reasonably identified. There may be circumstances, for instance, where a body within the responsible party, such as the board of directors, or a member of the same group of companies, wishes to have an independent assessment of certain activities of that responsible party, which are in effect its own operations. Provided that there are external user organisations that would benefit from such an engagement, this type of arrangement still conforms with the type of third party operations covered in this guidance, irrespective of whether the assurance report would be made available to the user organisations. Examples on the typical characteristics of assurance engagements on third party operations are available in Appendix 1.

TYPES AND ELEMENTS OF ASSURANCE ENGAGEMENTS OVER THIRD PARTY OPERATIONS

Types of Assurance engagements

- 18 An assurance engagement is carried out by the practitioner with the objective of conveying assurance either in a positive or negative form. The type of report is agreed at the start of the engagement between the practitioner and the client based on the expected evidence available to form such a conclusion and the requirements of the client.
- 19 Where the practitioner is able to reduce the assurance engagement risk to an acceptably low level in the specific engagement circumstances to issue a positive conclusion, the engagement is referred to as a reasonable assurance engagement.
- 20 Where the practitioner is able to reduce the assurance engagement risk to an acceptably low level but where the risk is nevertheless greater than that of a reasonable assurance engagement, the engagement is referred to as a limited assurance engagement. A limited assurance conclusion is typically expressed in a negative form in contrast to a reasonable assurance conclusion.

Elements of assurance engagements

- 21 The IAASB Assurance Framework discusses elements of an assurance engagement. This section expands upon certain aspects of these elements which are likely to require specific consideration where the assurance report is provided on third party operations. These elements are:

- a. Three party relationship
- b. An appropriate subject matter
- c. Suitable criteria
- d. Sufficient appropriate evidence; and
- e. A written assurance report in the form appropriate to the type of assurance engagement.

a. Three party relationship

- 22 Assurance engagements envisaged in this technical release involve three parties: the responsible party, user organisations, and the practitioner. The responsible party performs operations or provides information for the benefit of user organisations and hence is responsible for the subject matter over which assurance is sought. User organisations are typically the recipients of services, assets or information of the responsible party, although in some cases the relationship between a user organisation and a responsible party may not be simply one way⁴.
- 23 Where such a relationship exists, the practitioner may be engaged to perform an assurance engagement in relation to the operations of the responsible party or in relation to the information prepared about those operations. Specific definitions of the responsible party, user organisations and practitioner are given below.
- 24 Either the responsible party or user organisations, or in some circumstances both, may become a client.

⁴ For third party operations, the responsible party will typically be the party that provides services or assets to user organisations. However, this guidance also refers to a party that performs or shares activities as agreed with a business partner, for instance in a joint venture or as a customer who agrees to comply with certain conditions as a responsible party.

The responsible party

- 25 The responsible party typically performs operations or provides information for user organisations in a manner usually governed by a written contract.
- 26 The responsible party may also prepare its own report on the subject matter on which the practitioner performs the assurance engagement.

User organisations

- 27 User organisations are the parties that contract with the responsible party to perform specific activities for their benefit. Where appropriate, user organisations may also receive information in relation to the operations of the responsible party. Depending on the type of the operation performed or information provided by the responsible party, the number of user organisations and type of relevant criteria may vary. The assurance engagement may be performed in relation to all user organisations or may be restricted to specific user organisations. Where an assurance report is intended for specific user organisations, the assurance report clearly indicates that fact.
- 28 In some cases, there may be user organisations that are unidentified at the start of the engagement. This may happen where the responsible party intends to enable its prospective user organisations to view the report. Where this is the case, the risk of the assurance report being received by those who are not party to the engagement increases. The practitioner's duty of care needs to be clearly reflected in the engagement letter, in the assurance report and throughout the conduct of the engagement. See paragraph 56 for further guidance.

The practitioner

- 29 The practitioner performs the assurance engagement on the operations performed or information provided on such operations by the responsible party. The practitioner is governed by ethical and quality control requirements as set out in paragraphs 51–56.
- 30 The practitioner agrees with the client the scope of the engagement, the reporting requirements and ensures that there is secure appropriate access to the personnel and information of the responsible party and, if applicable, the user organisation(s).
- 31 The practitioner's responsibilities will vary depending on the client and their needs. To a large degree, those responsibilities and needs will be driven by whether the client is the responsible party, the user organisations or both. The practitioner considers whether the responsibilities have been defined to an appropriate level for the assignment including the nature of the deliverables when accepting an engagement.
- 32 In an assurance engagement, the practitioner is responsible for determining the nature, timing and extent of procedures. The practitioner also pursues, to the extent possible, any matter of which the practitioner becomes aware and which leads the practitioner to question whether a material modification should be made by the responsible party to the subject matter where possible or the subject matter information and to consider the effect on the assurance report if no modification is made.

b. An appropriate subject matter

- 33 The subject matter includes transactions, operations, or arrangements performed or provided by the responsible party on which the user organisations seek assurance. The responsible party may prepare a written representation about the subject matter (the subject matter information), for instance about its compliance with the agreed contract with the customer. The practitioner may be engaged to report either directly on the subject matter or on the subject matter information.

34 A written contract between the responsible party and the user organisations need to sufficiently describe the aspect of third party operations on which the practitioner performs an assurance engagement. When this does not exist, the practitioner may risk performing an assurance engagement on an inappropriate subject matter, which could lead to the practitioner issuing an inappropriate conclusion or one which is subject to misinterpretation by its recipient. Therefore the practitioner considers their responsibilities in relation to the assurance engagement and whether the subject matter has been defined to an appropriate level when accepting an engagement.

35 In assurance engagements over third party operations, the subject matter may take a number of different forms depending on what those operations are. It may comprise:

- Systems and processes (for example, an entity's internal controls or IT system) for which the subject matter information may be an assertion about effectiveness.
- Compliance with agreed contracts or other standards (for example, carrying out certain actions, providing certain information or meeting objective standards; for example, legal and regulatory requirements, ISO standards or industry regulation) for which the subject matter information may be an assertion about compliance therewith.
- Financial performance or conditions (for example, historical or prospective financial position, financial performance and cash flows) for which the subject matter information may be the recognition, measurement, presentation and disclosure in a financial statement or statements.
- Non-financial performance or conditions (for example, performance of a particular function) for which the subject matter information may be key indicators of performance, quantity, condition, efficiency or effectiveness.
- Physical characteristics (for example, capacity of a facility) for which the subject matter information may be a specifications document.
- Behaviour (for example, corporate governance, compliance with regulation, human resource practices) for which the subject matter information may be a statement of compliance or a statement of effectiveness.

The practitioner will consider whether he possesses the relevant skills and competence before agreeing to take on reporting against the subject matter, in particular non-financial performance, physical characteristics and behaviour.

36 Subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective and relates to a point in time or covers a period. Such characteristics affect:

- whether the subject matter is identifiable and capable of being consistently evaluated or measured against criteria; and
- the availability and the persuasiveness of evidence.

The practitioner considers whether the characteristics of the subject matter affect the type of assurance when accepting the engagement as this affects the criteria for assessing the information, evidence gathering and ultimately the assurance report. The assurance report notes any characteristics of particular relevance to the intended users of the report, if appropriate.

c. Suitable criteria

- 37 Assurance engagements require the practitioner to express an overall conclusion on the subject matter assessed in reference to certain criteria. Criteria also help the client and agreed recipients to understand how the practitioner has evaluated the subject matter to reach the conclusion. Criteria are dependent on the subject matter and may be already established or developed for a specific engagement.
- 38 The practitioner assesses the suitability of criteria for the purpose of a specific assurance engagement. Suitable criteria as set out in the IAASB Assurance Framework exhibit the following characteristics:
- **Relevance:** relevant criteria contribute to conclusions that assist decision-making by the intended users of the assurance report.
 - **Completeness:** criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
 - **Reliability:** reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
 - **Neutrality:** neutral criteria contribute to conclusions that are free from bias.
 - **Understandability:** understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.
- 39 Established criteria tend to be formal in nature, but the degree of formality depends on the subject matter. Criteria in areas such as compliance with legal or regulatory requirements may be widely recognised, either because they are available to the public or because there is an established standard, for example, BS7799 (information security management) and the COSO framework (internal control). Performance criteria may be set out in contractual arrangements as agreed with the user organisation. The practitioner considers the suitability of the criteria, in particular where established standards are used to ensure their relevance to the needs of the intended users of the assurance report.
- 40 Criteria may be developed specifically for the engagement where there are no suitable established criteria. Where criteria are developed for a specific engagement, the practitioner considers whether specifically developed criteria are suitable for the purpose of the engagement and considers obtaining a formal acknowledgement from the client and if appropriate also the responsible party or user organisation(s).
- 41 Criteria need to be available to all the addressees identified in the report. Established criteria are often publicly available and examples are given in Appendix 3. Where criteria are available only to specific parties, for instance in the terms of a contract, the use of the assurance report may need to be restricted to these parties.

Information related to COSO framework is available from www.coso.org and to BS7799 from www.bsi-global.com

d. Sufficient appropriate evidence

42 The practitioner plans and performs an assurance engagement with an attitude of professional scepticism to obtain sufficient appropriate evidence about whether the subject matter satisfies the criteria or the subject matter information is free of material misstatement. The practitioner considers materiality, assurance engagement risk, and the quantity and quality of available evidence when planning and performing the engagement, in particular when determining the nature, timing and extent of evidence-gathering procedures. Assurance engagement risk is the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.

e. A written assurance report

43 The practitioner provides a written report containing a conclusion that conveys the assurance obtained about the subject matter or subject matter information. In the context of assurance engagements over third party operations, ISAE 3000 provides basic elements for assurance reports as included in Appendix 2(i). In addition, the practitioner considers other reporting responsibilities, including communicating with those charged with governance where it is appropriate.

44 Where the subject matter information is made up of a number of aspects, separate conclusions may be provided on each aspect. While not all such conclusions need to relate to the same extent of evidence-gathering procedures, each conclusion is expressed in the form that is appropriate to either a reasonable assurance or a limited assurance engagement.

45 The IAASB Assurance Framework states that the practitioner expresses a qualified or adverse conclusion or a disclaimer of conclusion where:

- the practitioner concludes that there is not sufficient appropriate evidence to support an assurance conclusion due to the limitation on the scope of the practitioner's work;
- the responsible party's assertion or the report on the subject matter is materially misstated; or
- after accepting the engagement, the criteria or subject matter turns out to be inappropriate for an assurance engagement.

The practitioner may need to consider withdrawing from the engagement when necessary.

GUIDANCE FOR PRACTITIONERS

Accepting an engagement

- 46 The practitioner accepts an assurance engagement only where the practitioner's preliminary knowledge of the engagement circumstances indicates that:
- Relevant ethical requirements, such as independence, will be satisfied (see paragraphs 51–53): and
 - The engagement exhibits all of the following characteristics:
 - The subject matter is appropriate;
 - The criteria to be used are suitable and will be available to the intended users of the assurance report;
 - The practitioner will have access to sufficient appropriate evidence to support the conclusion;
 - The practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is to be contained in a written report;
 - The practitioner is satisfied that there is a rational purpose for the engagement. If there is a significant limitation on the scope of the practitioner's work, it is unlikely that the engagement has a rational purpose; and
 - The practitioner believes that the client has no intention to associate the practitioner's name with the subject matter or subject matter information in an inappropriate manner.
 - The engagement team collectively possesses the necessary professional competencies, having regard to the nature of the assignment. Where the required knowledge and skills are so specialised that the fundamental principle of competence is not expected to be met, the practitioner considers whether to accept the engagement.
- 47 The ability of the practitioner to perform the engagement and to report on the findings depends upon information and access being provided by the responsible party. The nature of the information and access required will be agreed where possible, formally and in writing, between the practitioner, the client, and where appropriate, other parties to the engagement. This requirement for information and access will be referred to in the engagement letter.
- 48 The practitioner ensures that there is sufficient clarity about the criteria that are to be applied during the engagement and in the assurance report by including appropriate references to the criteria in the engagement letter, particularly where the engagement requires the practitioner to examine the support for management assertions, for example concerning compliance with contractual terms or service standards.
- 49 The practitioner reads the terms of the contract agreed between the responsible party and the user organisations and consider the impact on the assurance engagement. For instance, unless specifically agreed in writing, the practitioner is not bound by any form of report or the terms of contract agreed between the client and any other party. Where the practitioner becomes aware that there is such an agreement and has identified that the form of report expected from the practitioner is inappropriate because the guidance in this technical release would not be met, the practitioner considers the implications of this for the engagement, which may ultimately result in the practitioner declining the engagement.

50 The assurance report may be received by a range of persons who are not party to the engagement. The practitioner does not normally intend to assume responsibility to persons who are not party to the engagement, but legal actions from such persons may nonetheless occur. The practitioner therefore needs to apply appropriate engagement acceptance procedures in order to assess the risks associated with taking on a particular engagement and accordingly whether to do so and, if so, on what terms. Where the practitioner accepts such an engagement, suitably rigorous internal risk management policies are applied to manage any increased level of risk. Guidance is available in AAF 04/06 *Assurance engagements: Management of risk and liability*.

Professional ethics and independence

- 51 Before accepting any professional engagement, the practitioner considers whether there are any ethical factors which should lead the practitioner to decline the appointment. Chartered accountants are subject to the ethical and other guidance laid down by the Institute, including the Fundamental Principles of the Code of Ethics, as set out in Statement 1.100 *Introduction and Fundamental Principles* in performing any professional services, to maintain the standard of their conduct. The ICAEW Code of Ethics is in compliance with the Code of Ethics established by the International Federation of Accountants.
- 52 When performing non-audit assurance engagements, the practitioner needs to consider applicable independence requirements set out in Statement 1.290 *Independence – Assurance Engagements*. Statement 1.290 is based on a conceptual approach that takes into account threats to independence, accepted safeguards and the public interest. Under this approach, firms and members of assurance teams have an obligation to identify and evaluate circumstances and relationships that create threats to independence and, where necessary, to take appropriate action to eliminate these threats or to reduce them to an acceptable level by the application of safeguards. In particular, appropriate consideration should also be given to independence of mind and in appearance in respect of the responsible party and user organisations. For example, the provision of assistance to a responsible party in preparing its report may result in a self-review threat if the impact of the assistance on the matter being reported on is subjective and material. The subjectivity of the report to be issued will also be relevant. If the practitioner identifies threats other than insignificant, safeguards need to be considered. These might include:
- The use of independent teams where appropriate; and
 - An independent review of the key judgements on the engagement.
- 53 The practitioner considers the existing relationships between the responsible party and the user organisation in this type of engagement. The practitioner considers the objectivity requirements in Statements 1.280 *Objectivity – all services* which is applicable to all services. Furthermore, a threat to the practitioner's objectivity or confidentiality may also be created when the practitioner performs services for clients whose interests are in conflict or the clients are in dispute with each other in relation to the matter or transaction in question. Statement 1.220 *Conflict of interest* sets out guidance on threats to objectivity or confidentiality when the practitioner provides services to multiple clients whose interests may be in conflict.

See www.icaew.com/ethics for the ICAEW Code of Ethics. For the IFAC Code of Ethics, see www.ifac.org

Quality control

- 54 The practitioner performs the assurance engagement in the same professional manner as any other engagement and in accordance with the scope agreed and recorded in the engagement letter. If it is necessary to depart from the terms of the engagement letter, the practitioner agrees an amended scope of work in writing with the client and with the other parties to the engagement. See paragraph 95 for further information on the circumstances where the practitioner is unable to obtain sufficient evidence.
- 55 When performing an assurance engagement under ISAE3000, the practitioner is subject to International Standard on Quality Control (ISQC) 1 *Quality control for firms that perform audits and reviews of historical financial information, other assurance and related services engagements*⁵. ISQC 1 requires that a firm of professional accountants has an obligation to establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with relevant professional standards and regulatory and legal requirements and that the assurance reports issued by the firm or engagement partners are appropriate in the circumstances.
- 56 The elements of such a system of quality control which are relevant to an individual engagement include leadership responsibilities for quality on the engagement, ethical requirements, acceptance and continuance of client relationships and specific engagements, assignment of engagement teams, engagement performance (in particular supervision, consultation, review and documentation) and monitoring.

To see the ICAEW guide *ISQC1 Quality control in the audit environment*, go to www.icaew.com/aaf and follow the link 'publication'. ISQC1 is published by the APB and is available from www.frc.org.uk/apb

Agreeing the terms of engagement

- 57 When the practitioner is requested to provide an assurance report on third party operations, it is important that there is a clear understanding and agreement concerning the scope and purpose of the engagement between the practitioner, the client and, where appropriate, other parties that are party to the engagement. To help avoid possible misunderstandings the agreed terms are recorded in writing. AAF 04/06 sets out detailed matters to note in relation to the terms of engagement and how the overall risks of the engagement may be managed by the practitioner. However, these will need to be carefully applied to the particular engagement circumstances because AAF 04/06 primarily focuses on situations where the responsible party is the client (see paragraphs 58–61 below). Paragraphs 62–65 below highlight some of the considerations which arise when the user organisation(s) is the client.

AAF 04/06 is available from www.icaew.com/assurance

Where the responsible party is the client

- 58 The responsible party may engage the practitioner to perform an assurance engagement to increase its own and user organisations' comfort over its operations performed in relation to user organisations. Where the responsible party engages the practitioner to perform an assurance engagement, it becomes responsible for enabling the practitioner to perform the necessary procedures to form the assurance conclusion. These include:
- providing sufficient access for the practitioner to allow performance of the necessary procedures. This should include access to personnel within the responsible party, as well as to premises and relevant operational and other records. The responsible party should also be made responsible for the completeness and accuracy of information supplied to the practitioner during the

⁵ In the UK, the Auditing Practices Board has issued ISQC 1 (UK and Ireland) for audits and other engagements where APB standards apply. ISQC 1 (UK and Ireland) is virtually identical to ISQC1 issued by International Federation of Accountants (IFAC).

course of the engagement. If the responsible party (or any other party to the engagement) restricts the practitioner from obtaining the evidence required to reach the assurance conclusion, this may be considered a material limitation on the scope of the practitioner's work and may affect the assurance conclusion. See paragraph 77 for further guidance on dealing with circumstances where the responsible party restricts the practitioner's access to obtaining necessary evidence;

- disclosing to the practitioner any significant changes or events that have occurred or are expected to occur that could reasonably be expected to have an effect on the assurance conclusion;
 - disclosing to the practitioner, and where appropriate, affected user organisation(s) any illegal acts, fraud, or uncorrected errors attributable to the responsible party's management or employees that may affect the user organisation(s), and the responsible party's whistle-blowing arrangements;
 - disclosing to the practitioner at the start of the engagement all other significant matters of which it is aware that affect the operations performed for the user organisation(s) as well as disclosing facts to the practitioner that may significantly impact or change the nature of the report or conclusion to be issued by the practitioner;
 - disclosing sufficient information to the practitioner to fully understand the requirements of the assignment. Failure to do so may mean that the requirements are not met by the procedures performed by the practitioner or relevant facts are not disclosed within the report of the practitioner;
 - disclosing significant issues within, and with, the user organisations that may have an impact on the scope of the engagement and the practitioner's conclusion; and
 - providing the practitioner with a letter of representation that includes the confirmation of the responsible party's responsibilities for the provision of information to the practitioner, and, where appropriate, that the responsible party has complied with the contractual requirements with user organisations and other relevant standards and obligation.
- 59 Where the responsible party reports on the subject matter, this may contain descriptions of the operations performed, the evaluation or assessment of the actual performance, any other relevant information (e.g. internal controls exercised over the operations) and any significant matters that the responsible party considers need to be brought to the attention of the user organisations. If the report constitutes the subject matter information, the practitioner assesses whether the responsible party's assertion that it has performed the operations as agreed with the user organisations based on suitable criteria and includes an assessment of the impact of exceptions and deficiencies disclosed in the report.
- 60 The responsible party is responsible for the completeness, accuracy, validity and method of presentation of the information within the responsible party's report. The assertions made in the report are also the responsibility of the responsible party and the practitioner obtains representations to that effect.
- 61 The practitioner considers the duty of care to its client. AAF 04/06 provides principles-based best practice guidance on the process that the practitioner undertakes when considering requests from the responsible party for assurance reports.

When the user organisations are the client

- 62 User organisations may engage the practitioner to assess aspects of the operations performed, or information provided, by the responsible party with a view to increasing their confidence in these aspects. The practitioner considers the increased assurance engagement risk when accepting an engagement assigned by the user organisations because the responsible party may not be part of the engagement which affects the practitioner's knowledge of the subject matter and evidence gathering process. In this type of engagement, the responsible party has a contractual obligation only to the user organisations and not to the practitioner.
- 63 Where the user organisations engage the practitioner to perform an assurance engagement, it is expected to fulfil its responsibilities, such as:
- providing sufficient access to the practitioner to perform necessary procedures. This should include access to personnel within the user organisation, as well as premises and relevant operational and other records. The user organisations are also responsible for the completeness and accuracy of information they supply to the practitioner during the course of the engagement.
 - arranging access for the practitioner to the responsible party's personnel, information and documentation. The user organisations and the responsible party will need to contract or agree other arrangements that are suitable for the practitioner to obtain sufficient information and evidence to support conclusions. If the responsible party (or any other party to the engagement) restricts the practitioner from obtaining the evidence required to reach the assurance conclusion, this may be considered a material limitation on the scope of the practitioner's work and may affect the assurance conclusion. See paragraph 76 for further guidance on dealing with circumstances when the responsible party restricts the practitioner's access to obtaining the necessary evidence;
 - disclosing to the practitioner any significant changes or event that have occurred or are expected to occur that could reasonably be expected to have an effect on the assurance conclusion;
 - disclosing sufficient information to enable the practitioner to fully understand the requirements of the assignment. Failure to do so may mean that the needs of the user organisations are not met by the procedures performed by the practitioner or relevant facts are not disclosed within the report of the practitioner;
 - disclosing significant issues within, and with, the responsible party, including illegal acts, fraud or uncorrected errors attributable to the responsible party's management or employees that may affect user organisations, and may have an impact on the scope of the engagement and the practitioner's conclusion to the extent that the user organisations are aware of such issues; and
 - disclosing to the practitioner all significant matters of which user organisations are aware that affect the operations performed for user organisations as well as disclosing facts to the practitioner that may significantly impact or change the nature of the report prepared by the practitioner, at the start of the engagement.
- 64 Although a management representation letter from the responsible party may not be obtainable for this type of engagement, the practitioner may find it useful to obtain a written confirmation from the responsible party on the factual findings and its responsibilities in relation to the subject matter (e.g. the terms of the contract) before releasing the draft report to the client. The practitioner may need to contract separately with the responsible party to ensure rights of access and agree information agreement protocols. The practitioner ensures that reporting protocols regarding

who has access to draft or final reports and the rights and obligations (for example to confirm factual accuracy of findings) of the responsible party to comment on, or require the practitioner to reflect comments in, the report, are agreed with the responsible party and where appropriate with the user organisations. The basis of such provision is agreed in writing and does not establish any additional duty of care outside the terms of the engagement.

- 65 The practitioner considers the duty of care to its client. While AAF 04/06 provides principles-based best practice guidance on process the practitioner takes when considering requests for assurance reports, it is designed for circumstances where the responsible party is the client. The practitioner may wish to seek independent legal advice where appropriate.

Planning and performing the engagement

- 66 The practitioner agrees with the client (and any other party to the engagement letter) the form of report that is appropriate for the purpose of the assurance engagement and the work to be performed. In an assurance engagement, the nature, timing, and extent of evidence-gathering procedures to be performed are planned in accordance with the type of assurance report to be issued.
- 67 The practitioner obtains an understanding of the subject matter and other engagement circumstances, sufficient to identify and assess the risks of the subject matter information or the assurance report on the subject matter being materially misstated and sufficient to design and perform evidence-gathering procedures.
- 68 Obtaining an understanding of the subject matter and other engagement circumstances such as whether the assurance report is to be made available to specific addressees only or for unidentified recipients is an essential part of planning and performing an assurance engagement. This understanding provides the practitioner with a frame of reference for exercising professional judgement throughout the engagement, for example, when considering the characteristics of the subject matter, assessing the suitability of criteria or determining the nature, timing and extent of procedures for gathering evidence.
- 69 As part of the engagement, the practitioner assesses the appropriateness of the subject matter based on the characteristics listed in paragraph 36. The practitioner also assesses the suitability of the criteria to evaluate or measure the subject matter. Suitable criteria have the characteristics listed in paragraph 38. As indicated in paragraph 46, the practitioner does not accept an assurance engagement unless the practitioner's preliminary knowledge of the engagement circumstances indicates that the subject matter is appropriate and criteria are suitable.
- 70 The scope and approach to be followed are communicated to the client and documented, normally in the form of an engagement plan or work programme and communicated to the engagement team.
- 71 The practitioner considers materiality when planning and performing an assurance engagement. The consideration of materiality is relevant when the practitioner determines the nature, timing and extent of evidence-gathering procedures and when evaluating whether the subject matter information is free of misstatement. Materiality is considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and extent of the effect of these factors on the evaluation or measurement of the subject matter and the interest of the user organisations. The practitioner uses professional judgement when assessing materiality and the relative importance of quantitative and qualitative factors in a particular engagement.

- 72 The practitioner applies procedures to reduce assurance engagement risk to an acceptably low level in the circumstances of the engagement in order to express the agreed type of assurance conclusion which might be either reasonable or limited assurance.
- 73 After accepting the engagement, if the practitioner concludes that the subject matter or criteria is not appropriate, the practitioner expresses a qualified or adverse conclusion or a disclaimer of conclusion. In some cases, the practitioner may consider withdrawing from the engagement.

Nature, timing and extent of tests

- 74 The practitioner obtains sufficient and appropriate evidence on which to base the practitioner's conclusion. The nature, timing and extent of work may differ according to the type of assurance engagement. Sufficiency is the measure of the quantity of evidence while appropriateness is the measure of the quality of evidence; that is, its relevance and its reliability. The practitioner uses professional judgement and exercises professional scepticism in evaluating the quantity and quality of evidence, and thus its sufficiency and appropriateness to support the assurance conclusion. The practitioner describes the tests performed to provide sufficient information to support the assurance conclusion.
- 75 The practitioner therefore plans the nature, timing and extent of work depending on the subject matter and criteria for the specific engagement. Whereas there is no guidance on evidence gathering when performing assurance engagements specifically over the operations performed by third parties, some of the existing standards or guidance on specific subject matters may provide useful information. Such sources are shown in Appendix 3.
- 76 In particular, depending on the nature of the subject matter, the practitioner may perform tests over a period of time or at a point in time. The decision affects whether the practitioner is able to report on the entire period covered in the assurance report. The practitioner describes the timing of tests and considers the impact on the assurance conclusion.
- 77 The practitioner may be prevented by the responsible party from access to personnel, premises or operational information during the course of the assignment, in particular when the client is user organisations. Similarly, there may be circumstances beyond the control of the client, regardless of whether the client is the responsible party or the user organisation, where sufficient appropriate evidence may not be available. The practitioner considers whether these restrictions have an impact on the assurance report. Where the practitioner's work is affected by restricted access, the practitioner may need to consider whether to issue a qualified or adverse conclusion, issue a disclaimer of a conclusion, or where appropriate, withdraw from the engagement.

Responsible parties that use other organisations

- 78** The practitioner may become aware that the responsible party contracts out part of the functions that significantly affect the operations it performs for the user organisation. The responsible party may also have arrangements with another organisation to provide services that significantly affect the overall operations of the responsible party, affecting the functions that the responsible party performs for user organisations. The entity to whom the responsible party contracts out a significant part of its operations is referred to in this guidance as a significant external service provider. For example, a payroll outsourcing organisation may in turn outsource aspects of its information processing to a third party. A pharmaceutical company may have its distribution organised by a service provider that subcontracts logistics in a particular jurisdiction (where it does not have a suitable presence itself) to another organisation that does.
- 79** The practitioner considers the extent to which subject matter is provided by a significant external service provider to the responsible party and whether the scope of the engagement needs to include consideration of the part of operations provided by the significant external service provider and whether such access is available. If such access is not available and this restricts the practitioner from obtaining the evidence required in reaching the assurance conclusion, the practitioner considers whether this may result in a material limitation on the scope of the practitioner's work the requirement to issue a qualified or adverse conclusion, issue a disclaimer of a conclusion, or where appropriate, withdraw from the engagement.
- 80** Where the involvement of a significant external service provider is known prior to the engagement, the practitioner discusses with the client, regardless of whether it is the responsible party or user organisations, whether the scope of the engagement includes the assessment of functions provided by the significant external service provider. If such involvement is identified during the engagement a similar discussion is undertaken and any amendments to engagement terms and scope are agreed in writing.
- 81** Depending on the discussion, the practitioner and the client agree in writing how the functions performed by the significant external service provider should be dealt with.
- In the case where the practitioner and the client agree that the scope of the practitioner's work excludes externally provided functions, the report on the functions performed by the responsible party describes the functions performed by the significant external service provider in sufficient detail for the user to understand the scope of the practitioner's work and the limitation thereon.
 - Where the scope of the engagement includes externally provided functions, the practitioner performs procedures that may include, but are not limited to:
 - describing the functions performed by the significant external service provider, differentiating the role of the responsible party and the significant external service provider. To accomplish this, the practitioner may request the responsible party to co-ordinate with the significant external service provider;
 - reviewing the qualification of the significant external service provider to establish whether any further work would be required;
 - reviewing the contract between the responsible party and the significant external service provider to establish to what extent the practitioner may rely on reports from the significant external service provider, including an assurance report on the services provided by the service provider if available. Where the practitioner plans to use the reports received from the significant external service provider,

the practitioner considers the professional competence of the preparer of the report including professional qualifications and experience. The practitioner perform procedures to obtain sufficient appropriate evidence that the externally prepared report is adequate for the practitioners purposes in the context of the engagement covered in this guidance;

- performing procedures directly on the functions provided by the significant external service provider, if appropriate.

82 If no suitable approach can be determined, the practitioner discusses this limitation with the client and concludes, in the light of the available information, whether to issue a qualified or adverse conclusion, issue a disclaimer of a conclusion, or where appropriate, withdraw from the engagement.

Considering subsequent events

83 The practitioner considers the effect on the subject matter information and on the assurance report of events up to the date of the assurance report. The extent of consideration of subsequent events depends on the extent such events may affect the subject matter information and the appropriateness of the practitioner's conclusion. For example, when the engagement requires a conclusion about the accuracy of historical information at a point in time, events occurring between that point in time and the date of the assurance report may not affect the conclusion or require disclosure.

Documentation

84 The practitioner documents matters that are significant and relevant to support the assurance report and that the engagement was performed as agreed with the client and as set out in the engagement letter. The documentation may include the description of the extent, nature and results of tests, sampling, evidence to support the practitioner's conclusion and a record of the practitioner's reasoning on significant matters that require the exercise of judgement and relevant facts⁶.

Assurance reporting

- 85 The practitioner prepares a written report expressing the assurance conclusion and refers to the key elements of the assurance report shown in the table in Appendix 2(ii)(a). The practitioner tailors these elements for the specific engagement depending on the subject matter and, where appropriate, adapts for a qualified conclusion. Illustrative assurance reports on third party operations, derived from existing guidance, are available in Appendix 2(ii)(b)⁷.
- 86 The title of the report includes the term 'assurance' to distinguish it from non assurance engagements, for instance agreed-upon procedures engagements. The report draws the attention of the addressees to the basis of the practitioner's work, e.g. ISAE 3000 and this technical release.
- 87 The assurance report reflects the agreement set out in the engagement letter and is supported by the work carried out by the practitioner. The report makes clear for whom it is prepared, who may have access to it, and who is entitled to rely upon it and for what purpose, in accordance with the engagement terms. The practitioner also refers to the guidance in AAF 04/06.

⁶ Additional guidance on documentation can be found in paragraph 42-44 of ISAE 3000 which sets out high level principles. The IAASB is currently drafting ISAE 3402 *Assurance reports on a service organization's controls* at the time of publication of this technical release and practitioners have regard to further guidance set out in ISAE 3402 as it progresses towards finalisation.

⁷ The illustrative reports in Appendix 2(ii) are examples of reasonable assurance conclusions. The guidance does not preclude a limited assurance report where the practitioner and the client agree on the form of the report.

- 88 Where relevant, the practitioner considers a form of report to be issued by the practitioner, agreed between the responsible party and user organisation but without the practitioner's consent. The form of report requested by the responsible party or user organisation(s) may be inappropriate because the considerations in this guidance are not met. In such circumstances, the practitioner does not agree to issue such a report.
- 89 Where the practitioner is also the auditor of the responsible party, the practitioner may include a statement that by delivering the assurance report the practitioner accepts no additional duties in relation to the statutory audit.
- 90 The practitioner describes any significant, inherent limitation associated with the evaluation or measurement of the subject matter against the criteria in the assurance report.
- 91 Where the responsible party decides the scope of engagement or, in particular, provides the subject matter information, the practitioner communicates the fact, including how the scope of the report is defined and how the criteria have been selected, in the assurance report.
- 92 In order for the assurance conclusion not to be misleading, the practitioner needs to consider whether subject matter information provided by the responsible party is complete. The practitioner does not provide an unqualified conclusion where the practitioner becomes aware that the responsible party's set of assertions is incomplete in any material respect.
- 93 The assurance report states the restrictions on its replication in whole or in part in other published documents. The practitioner also refers to the guidance in AAF 04/06.
- 94 Based on the relevant evidence obtained during the engagement, the practitioner concludes whether the assurance objective has been met. The objective would be for either a positive or negative assurance conclusion to be issued in accordance with the type of assurance as agreed at the start of the engagement.
- 95 The practitioner may become aware that the evidence is insufficient to issue the agreed type of assurance conclusion. Insufficient evidence does not however constitute a valid reason for making a change in the agreed type of engagement, for instance, from a reasonable assurance engagement to a limited assurance engagement or from an assurance engagement to non-assurance engagement. The practitioner, however, considers whether to issue a qualified or adverse conclusion, issue a disclaimer of a conclusion, or where appropriate, withdraw from the engagement.
- 96 As discussed in paragraph 64, the practitioner may wish, or be required, to provide the draft findings to the responsible party before releasing it to the user organisations for confirmation of the factual accuracy of the details, so that any misunderstandings or unintended limitations of the documentation provided to the practitioner may be addressed or rectified before the report is released to the client where, in particular, it is the user organisations. The basis of such provision is agreed in writing and does not establish any additional duty of care outside the terms of the engagement.

Other reporting responsibilities

- 97 The practitioner considers other information supplied by the responsible party or user organisations. If such other information is inconsistent with the assurance conclusion or with other matters that the practitioner is or has become aware of, the practitioner discusses this with the client and may wish to draw attention to the fact in the assurance report.

98 The practitioner only signs the assurance report as agreed in the engagement letter if sufficient and appropriate evidence to support the assurance conclusion is obtained. Where either the responsible party or user organisations subsequently asks the practitioner to provide reports on related matters which are not directly covered by the scope of the engagement, the practitioner is unlikely to be able to issue such reports. The practitioner may, however, be able to issue an alternative form of report which is capable of being supported by work performed as part of the engagement, such as a report of the factual findings of agreed-upon procedures. The practitioner agrees a separate engagement for such assignment with the party that requests an additional report.

Using the work of internal auditors

99 A responsible party may have an internal audit department that as part of its audit plan performs tests of some aspects of the operations which are also the subject of the assurance report. The practitioner may wish to consider whether it might be effective and efficient to use the results of testing performed by internal auditors to alter the nature, timing or extent of the work the practitioner otherwise might have performed in forming the assurance conclusion. Where using the work of internal auditors, the practitioner performs sufficient testing which provides the principal evidence for the assurance conclusion and assesses the independence and competence of the internal auditors where changing the nature, timing or extent of the practitioner's testing. The practitioner also makes reference to the internal auditors in the assurance report and clarifies the extent of use of internal auditors' work.

Consideration of uncorrected errors, fraud or illegal acts

100 While performing procedures on the operations performed by third parties, the practitioner may become aware of uncorrected errors, fraud or illegal acts attributable to the responsible party's systems, management or employees that may affect the functions that interact with the user organisation.

101 Unless clearly inconsequential, the practitioner determines from the responsible party whether this information has been communicated to the affected user organisations. If the responsible party has not communicated this information to the user organisations and is unwilling to do so, then the practitioner considers the implications for the engagement. Where the engagement is with the responsible party, the practitioner informs the responsible party's audit committee or other management with equivalent authority. If the audit committee or equivalent authority does not respond appropriately, the practitioner considers whether to resign from the engagement and whether any other action or reporting is appropriate such as to report in the public interest.

102 The practitioner is generally not required to confirm with the user organisations whether the responsible party has communicated such information. However, if the client is user organisations, the practitioner considers the materiality of the matter and whether the matter has been brought to the attention of the responsible party and promptly corrected. Depending on the outcome, the practitioner may consider communicating the matter to the user organisations.

Further guidance on anti-money laundering is available in the ICAEW Technical Release TECH 12/04 *Anti-money laundering – 2nd interim guidance*. The ICAEW is currently undertaking a comprehensive revision of the Guidance, which will be available in the autumn of 2007.

Management representation letter

- 103** The practitioner normally obtains written representations or a form of written confirmation as referred to in paragraph 64 signed by the directors of the responsible party who are responsible for and knowledgeable, directly or through others within the responsible party, about the subject matter. The refusal by the directors of the responsible party to provide written representations considered necessary by the practitioner may constitute a limitation on the scope of the engagement. The representation letter and the assurance report are both dated as of the completion of the engagement.
- 104** Management representations cannot replace other evidence that the practitioner could reasonably be able to obtain. Where the practitioner is unable to obtain sufficient appropriate evidence regarding a matter that has, or may have, a material effect on the evaluation or measurement of the subject matter, when such evidence would ordinarily be expected to be available, the practitioner considers if it would constitute a limitation on the scope of the engagement even if management representations are available.
- 105** The practitioner is associated with a subject matter when the practitioner reports on information about that subject matter or consents to the use of the practitioner's name in a professional connection with respect to that subject matter. If the practitioner learns that the client (or any other party) is inappropriately using the practitioner's name in association with a subject matter, the practitioner requires the client to cease doing so. The practitioner may also consider what other steps may be needed, such as informing any known parties that may have received the report that inappropriately uses the practitioner's name and seeking legal advice.

APPENDICES

1. Characteristics of third party operations and assurance engagements

A number of characteristics of the relationship between the responsible party and user organisations may affect the nature of the engagement, as well as the requirements of the clients. The characteristics set out below are often important when considering the risk profile of an engagement. These characteristics are illustrative only and neither mutually exclusive nor exhaustive. Other relevant characteristics also need to be considered for their impact on the specific engagement as appropriate. The characteristics discussed in this appendix are:

- a. Whether the engagement is initiated by the responsible party or by user organisations;
- b. Whether outsourced services or functions form part of the user organisations' internal control/operational environment or whether the subject matter relates to a procurement or other business activity which does not; and
- c. Whether the evaluation of the subject matter against the selected criteria is performed and reported to user organisations by the responsible party or the practitioners.

a. Engagements initiated by the responsible party or by user organisations

An assurance engagement may be initiated by the responsible party or user organisations, and may be performed to cover overall aspects of performance or to address specific risks or concerns.

An engagement covering wider aspects of a subject matter is typically performed where a responsible party intends to demonstrate to existing and potential user organisations that it performs the relevant services or functions as agreed or to meet a desired standard. The responsible party is likely to be the client and hence defines the scope of the engagement. Some user organisations may be involved in discussions with the responsible party over setting the scope of the engagement. Where user organisations are unidentified or many, it may be difficult to reasonably understand their expectations or needs when identifying suitable criteria. This may affect the practitioner's decision on who may receive the report and to whom the practitioner owes a duty of care.

The responsible party may find the need to defend itself against repeated reviews by user organisations, or respond to the general scrutiny over the provision of particular types of service in the market place. The responsible party, who typically would be the client in this situation, may specify at the start of the engagement which user organisations may have access to the assurance report. The practitioner may wish to refer to AAF 04/06 for guidance in this regard.

User organisations may commission an engagement to have the responsible party's services or functions assessed with specific concerns in mind. This may mean that the practitioner will assess the responsible party's operations to establish if the responsible party's activities for mitigating or managing the user organisation's concerns are appropriate and sufficient.

Alternatively, user organisations may contract with the practitioner to perform an assurance engagement on specific aspects of operations performed by, or reported by, the responsible party; for instance to confirm the accuracy of the fee

charged for the service provided by the responsible party. In this case, the practitioner is likely to be engaged to directly report on the operations the responsible party performs as the subject matter and the client may be the only addressee of the report.

b. Outsourced services or functions that form part of the user organisation's internal control/operational environment

Some organisations outsource parts of their operations. Outsourcing may be regular and continuous, ad-hoc or possibly one-off. The process of outsourcing to a responsible party does not take away a user organisation's need to maintain its oversight, its overall responsibility and, in some cases, a level of management of the outsourced activities and functions. An assurance conclusion from the practitioner may be helpful for the user organisation in demonstrating that it is meeting aspects of its responsibility over the outsourced activity and could form, for instance, part of information requested within the scope of statutory audit of the user organisation.

Typically, the requirement for assurance is over the ongoing performance of the outsourced activities to contractually agreed (and other) standards, which may include reference to specific criteria and service level agreements about, for example, internal control standards or key performance indicators.

In procurement, a user organisation may have pre-requisites for contractual standards that a successful tenderer is expected to meet. In these cases, the practitioner may be engaged by the user organisation to assess whether the tenderer (prospective responsible party) satisfies the requirements or by a tenderer to strengthen its bid.

On an on-going basis, a business may wish to obtain assurance that its suppliers (responsible parties) are continuously compliant with contractually agreed standards. Alternatively, a supplier may wish to be able to demonstrate to its customer (user) organisations that it is in compliance with particular standards.

There are other similar relationships that arise from other business activities. Relationships with agents and distributors, such as sales agents, may give rise to circumstances where one party needs to increase the confidence of the other party about its performance. Similar situations arise under licence agreements. In practice, the form of assurance sought in such cases is likely to be specific to particular risks or concerns and is more likely to originate from the beneficiary (user organisation) rather than the agent or licensee (responsible party). An assurance engagement may be commissioned, for instance, on regularly reported information that forms the basis for the calculation of payments by the beneficiary.

c. Reporting of subject matter information by the responsible party or the practitioners

Evaluation of the subject matter against the selected criteria may be carried out by the responsible party, the user organisation, or the practitioner.

Where the practitioner gives a conclusion on the outcome of the evaluation or measurement (subject matter information) performed either by the responsible party or by a user organisation, it is referred to as an 'assertion-based engagement' as the preparer of the report on the information will make a statement or assertion about its view of the subject matter. Assertions may be about the effectiveness of operations or controls, about the accuracy of performance statistics or about compliance with a contract or with relevant standards. The report may set out facts about the operations of the responsible party and the outcome of its own evaluation and assessment of the operations measured against, for instance, the terms of the contract or relevant standards. The practitioner may be engaged to form a view on the assertions made in the report. In this case, the practitioner is likely to use the criteria used in the report for conducting the engagement, having assessed the suitability of the criteria.

Where the practitioner directly evaluates or measures the subject matter and issues an assurance conclusion, it is referred to as a 'direct reporting engagement'. The practitioner's report describes the operations of the responsible party, how the practitioner assessed the subject matter and the criteria used to communicate the basis of the conclusion. The criteria used are typically determined by the practitioner for direct reporting engagements, but may be discussed for suitability with the client.

2. Assurance report

(i) Illustrative contents of an assurance report

The contents that are consistent with ISAE 3000 are shown in bold below. The remainder are not covered in ISAE 3000 but have been discussed in this guidance.

- (a) A title indicating that the report is an assurance report.
- (b) An addressee identifying the parties to whom the assurance report is directed.
- (c) Identification of the applicable engagement letter.
- (d) Restrictions on the use of the assurance report to the client [and other parties to the engagement letter] and on the replication of the report in whole or in part.
- (e) Limitation of the liability of the practitioner to the client [and other parties to the engagement letter].
- (f) An identification and description of the subject matter information and when appropriate, the subject matter.
- (g) The identification of the responsible party, [user organisation(s)] and the respective responsibilities of the client and the practitioner.
- (h) Reference to applicable standard and guidance, including this technical release.
- (i) Identification of the criteria against which the subject matter is evaluated or measured.
- (j) A summary of the work performed including the period covered and frequency of tests, if appropriate.
- (k) Inherent limitations associated with the evaluation or measurement of the subject matter against the criteria and any limitations on scope incurred during the work.
- (l) Where the criteria used to evaluate or measure the subject matter are available only to specific recipient of the assurance report, or are relevant only to a specific purpose, a statement restricting the use of the assurance report to those intended recipients or that purpose and wording setting out matters related to the practitioner's duty of care.
- (m) The practitioner's conclusion in the agreed form (with or without 'except for's), adverse conclusion or disclaimer of a conclusion - with the description of the practitioner's findings including sufficient details of errors and exceptions found. Where appropriate, the conclusion should inform the intended users of the context in which the practitioner's conclusion is to be read.
- (n) The name and signature of the firm/ practitioner and the location of the office performing the engagement.
- (o) The assurance report date.

(ii) Example assurance reports on third party operations

The following extracts are taken from (a) AAF 01/06 *Assurance reports on internal controls of service organisations made available to third parties*⁸ and (b) FIT 01/07 *Assurance reports on the outsourced provision of information services and information processing services by service organisations made available to third parties*.

(a) Reporting accountants' assurance report on internal controls of service organisations⁹

To the directors of [name of entity] and [customers party to the engagement]

Use of report¹⁰

This report is made solely for the use of the directors, as a body, of [name of entity] and [customers party to the engagement], and solely for the purpose of reporting on the internal controls of [name of entity], in accordance with the terms of our engagement letter dated [date] [and attached¹¹ as appendix []].

Our work has been undertaken so that we might report to the directors and [customers party to the engagement] those matters that we have agreed to state to them in this report and for no other purpose. Our report must not be recited or referred to in whole or in part in any other document nor made available, copied or recited to any other party, in any circumstances, without our express prior written permission.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the directors as a body, [name of entity] and [customers party to the engagement] for our work, for this report or for the opinions we have formed.

Subject matter

This report covers solely the internal controls of [name of entity] as described in your report as at [date]. Internal controls are processes designed to provide reasonable assurance regarding the level of control over customers' assets and related transactions achieved by [name of entity] in the provision of [outsourced activities] by [name of entity].

Respective responsibilities

The directors' responsibilities and assertions are set out on page [] of your report. Our responsibility is to form an independent conclusion, based on the work carried out in relation to the control procedures of [name of entity]'s [] function carried out at the specified business units of [name of entity] [located at []] as described in the directors' report and report this to the directors of [name of entity] and [customers party to the engagement].

Criteria and scope

We conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE) 3000 and the Institute of Chartered Accountants in England and Wales Technical Release AAF 01/06. The criteria against which the control procedures were evaluated are the internal control objectives

⁸ AAF 01/06 was issued by the ICAEW in June 2006 to provide guidance to reporting accountants on undertaking an assurance engagement and providing a report in relation to internal controls of a service organisation. AAF 01/06 does not constitute an auditing standard. Professional judgement should be used in its application, and where appropriate, legal assistance should be sought. No responsibility for loss occasioned to any person acting or refraining from acting as a result of any material in AAF 01/06 can be accepted by the ICAEW. The full report is available to download at www.icaew.co.uk/assurance.

⁹ Reporting accountants consider a suitable form of report in accordance with the specific engagement. This report provides an example for an engagement to which the service organisation and the customers of the service organisation are party.

¹⁰ The two last paragraphs in "Use of report" provide example wording, disclaiming reporting accountants' liability or duty to the customers that are not party to the engagement. Reporting accountants consider the legal effectiveness of disclaiming liability in the particular circumstances of their engagement.

¹¹ Reporting accountants that do not attach the engagement letter consider including relevant extracts.

developed for service organisations as set out within the Technical Release AAF 01/06 and identified by the directors as relevant control objectives relating to the level of control over customers' assets and related transactions in the provision of [outsourced activities].

Our work was based upon obtaining an understanding of the control procedures as described on page [] to [] in the report by the directors, and evaluating the directors' assertions as described on page [] to [] in the same report to obtain reasonable assurance so as to form our conclusion. Our work also included tests of specific control procedures, to obtain evidence about their effectiveness in meeting the related control objectives. The nature, timing and extent of the tests we applied are detailed on pages [] to [].

Our tests are related to [name of entity] as a whole rather than performed to meet the needs of any particular customer.

Inherent limitations

Control procedures designed to address specified control objectives are subject to inherent limitations and, accordingly, errors or irregularities may occur and not be detected. Such control procedures cannot guarantee protection against (among other things) fraudulent collusion especially on the part of those holding positions of authority or trust.

Furthermore, our conclusion is based on historical information and the projection of any information or conclusions in the attached report to any future periods would be inappropriate.

Conclusion

In our opinion, in all material respects:

1. the accompanying report by the directors describes fairly the control procedures that relate to the control objectives referred to above which were in place as at [date];
2. the control procedures described on pages [] to [] were suitably designed such that there is reasonable, but not absolute, assurance that the specified control objectives would have been achieved if the described control procedures were complied with satisfactorily [and customers applied the control procedures contemplated]; and
3. the control procedures that were tested, as set out in the attachment to this report, were operating with sufficient effectiveness for us to obtain reasonable, but not absolute, assurance that the related control objectives were achieved in the period [x] to [y].

Name of firm

Chartered Accountants

Location

Date

(b) Assurance reports on the outsourced provision of information services and information processing services¹²

Reporting accountants' assurance report, made available to third parties, on control procedures of service organisations¹³ providing information services [/information processing services]

To the directors of [name of entity] and [customers party to the engagement]

Use of report¹⁴

This report is made solely for the use of the directors, as a body, of [name of entity] and [customers party to the engagement], and solely for the purpose of reporting on the control procedures of [name of entity], in accordance with the terms of our engagement letter dated [date] [and attached¹⁵ as appendix []].

Our work has been undertaken so that we might report to the directors and [customers party to the engagement] those matters that we have agreed to state to them in this report and for no other purpose. Our report must not be recited or referred to in whole or in part in any other document nor made available, copied or recited to any other party, in any circumstances, without our express prior written permission.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the directors as a body, [name of entity] and [customers party to the engagement] for our work, for this report or for the conclusions we have formed.

Subject matter

This report covers solely the control procedures of [name of entity] as described in the directors' report as at [date]. Control procedures are designed to provide reasonable assurance regarding the level of control over the information services [/information processing services] provided by [name of entity].

Respective responsibilities

The directors' responsibilities and assertions are set out on page [] of the directors' report. Our responsibility is to form an independent conclusion, based on the work carried out in relation to the control procedures of [name of entity]'s information services [/information processing services] carried out at the specified business units of [name of entity] [located at []] as described in the directors' report and report this to the directors of [name of entity] and [customers party to the engagement].

Criteria and scope

We conducted our engagement in accordance with International Standard on Assurance Engagement 3000 and the Institute of Chartered Accountants in England and Wales Technical Release ITF 01/07. The criteria against which the control procedures were evaluated are the control objectives developed for the service organisation in reference to the control objectives as set out within ITF 01/07 and identified by the directors as relevant control objectives relating to the level of control over the information services [/information processing

¹² This guidance is jointly issued by the Information Technology Faculty and Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales in April 2007. The technical release does not constitute an auditing standard. Professional judgement should be used in its application, and where appropriate, professional legal assistance should be sought.

¹³ Reporting accountants consider a suitable form of report in accordance with the specific engagement. This report provides an example for an engagement to which the service organisation and the customers of the service organisation are party.

¹⁴ The two last paragraphs in 'Use of report' provide example wording, disclaiming reporting accountants' liability or duty to the customers that are not party to the engagement. Reporting accountants consider the legal effectiveness of disclaiming liability in the particular circumstances of their engagement.

¹⁵ Reporting accountants that do not attach the engagement letter consider including relevant extracts.

services] provided by [name of entity] [as outsourced activities]. Our work was based upon obtaining an understanding of the control procedures as described on page [] to [] in the report by the directors, and evaluating the directors' assertions as described on page [] to [] in the same report to obtain reasonable assurance so as to form our conclusion. [Our work also included tests of specific control procedures, to obtain evidence about their effectiveness in meeting the related control objectives. The nature, timing and extent of the tests we applied are detailed on pages [] to [].]

Our tests are related to [name of entity] as a whole rather than performed to meet the needs of any particular user.

Inherent limitations

Control procedures designed to address specified control objectives are subject to inherent limitations and, accordingly, errors or irregularities may occur and not be detected. Such control procedures cannot guarantee protection against (among other things) fraudulent collusion especially on the part of those holding positions of authority or trust. Furthermore, our conclusion is based on historical information and the projection of any information or conclusions in the attached report to any future periods would be inappropriate.

Conclusion

In our opinion, in all material respects:

1. the accompanying report by the directors describes fairly the control procedures that relate to the control objectives referred to above which were in place as at [date];
2. the control procedures described on pages [] to [] were suitably designed such that there is reasonable, but not absolute, assurance that the specified control objectives would have been achieved if the described control procedures were complied with satisfactorily [and customers applied the control procedures contemplated]; and
- [3. the control procedures that were tested, as set out in the attachment to this report, were operating with sufficient effectiveness for us to obtain reasonable, but not absolute, assurance that the related control objectives were achieved in the period [x] to [y].]

Name of firm

Chartered Accountants

Location

Date

3. Criteria

As stated in paragraphs 37 to 41, assurance engagements require the practitioner to express an overall conclusion on the information assessed relative to certain criteria.

While criteria may be specifically developed for an engagement where there are no suitable established criteria, there is a number of standards and guidance that may be relevant to the assurance engagements over different types of third party operations. Such standards and guidance provide a suitable basis for criteria which the responsible party may use to develop its criteria. The directors of responsible party ensure that these criteria meet the characteristics listed in paragraph 39 and consider if these are sufficient to meet the expectations of the user organisation.

These suggestions are set out for guidance only and are not intended to be exhaustive. Directors should describe, as an integral and essential part of their report, a complete set of criteria. It remains the responsibility of the directors to ensure that the described criteria are sufficient to meet the expectations of the user organisation.

Internal controls

- AAF 01/06 *Guidance on Assurance reports on internal controls of service organisations made available to third parties*, published by the Audit and Assurance Faculty in 2006 and replacing FRAG 21/94 (revised) (AUDIT 4/97) *Reports of Internal Controls of Investment Custodians Made Available to Third Parties* provides internal control objectives for financial services.
- The report from the Committee of Sponsoring Organizations of the Treadway Commission (COSO): *Enterprise Risk Management — Integrated Framework* (September 2004). www.coso.org

IT Risk management

- Guidance from the International Federation of Accountants (IFAC): *E-Business and the Accountant: Risk Management for Accounting Systems in an E-Business Environment*, a discussion paper including comments on E-business assurance and advisory services. www.ifac.org/store
- International Auditing and Assurance Standards Board (IAASB):
 - IAPS 1013 *“Electronic Commerce: Effect on the Audit of Financial Statements”*
 - IAPS 1008 *“Risk Assessments and Internal Control–CIS Characteristics and Considerations”*
 - IAPS 1002 *“CIS Environments–Online Computer Systems”*
 - IAPS 1003 *“CIS Environments–Database Systems”*.
- British Standards Institution: BS ISO/IEC 27001:2005 (BS 7799-2:2005) BS ISO/IEC 17799:2005: international/British standards on information security management. (Part of ISO 9000:2000 series: international standards on quality management.) www.bsi-global.com
- ISACA (formerly Information Systems Audit & Control Association): *Control Objectives for Information and related Technology (CobiT)*. www.isaca.org

- The IT Governance Institute (ITGI; part of ISACA): a reference guide, entitled *IT Control Objectives for Sarbanes-Oxley*, which maps many of the CobiT control objectives to the COSO framework for internal control. www.itgi.org
- *Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.*
- The ITIL (*IT Infrastructure Library*), forming the basis of the BS ISO/IEC 20000 (formerly BS 15000) standard. ITIL has been widely adopted across Europe as the standard for best practice in the provision of IT Service. Although the ITIL covers a number of areas, its main focus is on IT Service Management (ITSM). ITSM itself is divided into two main areas: Service Support and Service Delivery. www.itil.org.uk

4. References

The ICAEW

AAF 01/06 *Assurance reports on internal controls of service organisations made available to third parties*, 2006

AAF 04/06 *Assurance engagements: Management of risk and liability*, 2006

Code of Ethics (UK and Ireland), 2006

ITF 01/07 *Assurance reports on the outsourced provision of information services and information processing services*, 2007

Other

The Auditing Practices Board

International Standard on Quality Control (ISQC) (UK and Ireland) 1 *Quality control for firms that perform audits and reviews of historical financial information, other assurance and related services engagements*, amended by conforming amendments introduced by ISA (UK and Ireland) 230 (Revised), 2006

The International Auditing and Assurance Standards Board

The International Framework for Assurance Engagements, 2004

ISAE 3000 *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*, 2004

International Federation of Accountants

International Standard on Quality Control (ISQC) 1 *Quality control for firms that perform audits and reviews of historical financial information, other assurance and related services engagements*, 2006

A FRAMEWORK FOR ASSURANCE REPORTS ON THIRD PARTY OPERATIONS

Technical Release AAF 02/07

AAF 02/07 is issued by the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) in November 2007. AAF 02/07 gives guidance on providing assurance services on different aspects of business relationships between two or more parties. AAF 02/07 does not constitute an auditing or assurance standard. Professional judgement should be used in its application, and where appropriate, professional legal assistance should be sought.