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APPENDIX B

Overview of Service Organization Engagements Performed Under SSAE No. 16 (SOC 1 Engagements)

INTRODUCTION

An auditor performing a financial statement audit is required to understand the client entity and its environment, including its internal control. If the entity (the *user entity*) engages another entity (a *service organization*) to process its transactions, the auditor (the *user auditor*) needs to consider the controls at the service organization to the extent he would if those functions were performed by the user entity itself. Accordingly, the user auditor needs to understand and evaluate the processing of the user entity's transactions by the service organization as long as those services are likely to be relevant to the user entity's internal control over financial reporting.

A service organization report deals with the internal controls the service organization applies to user entities' transactions, that is, the portion of the processing that user entities would perform themselves had they not engaged the service organization. Service organization reports do not cover the internal controls a service organization applies to its own transactions. These transactions can include such items as the processing of the service organization's payroll, cash disbursements, the purchasing function, recording fixed assets, and other changes to the service organization's accounting records.

In a service organization engagement[a] performed under SSAE No. 16 (AT 801), *Reporting on Controls at a Service Organization*, the service organization develops a description of its relevant processes and related controls (referred to in these Practice Aids as *management's description of the service organization's system*) and engages an auditor (a *service auditor*) to apply procedures and report on the controls identified therein. There are two types of reports that service auditors provide on service organizations' internal controls for the benefit of user entities and their auditors:

- A report on management's description of a service organization's system and the suitability of the design of controls (a Type 1 report). It incorporates management's description as of a point in time and its assertions about both the fair presentation and the suitability of the design to controls to achieve the control objectives included in the description.
- A report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls (a Type 2 report), which provides the same information as a Type 1 report, although for a specified period of time rather than as of a point in time, plus an opinion on whether the controls operated effectively. In addition, it provides a description of the tests of controls performed by the service auditor and the results of such tests. It incorporates management's assertions about the effectiveness of controls in addition to those about fair presentation and suitability of design.

Although a service auditor is often the same practitioner who audits the service organization's financial statements, a service organization might engage different auditors for the two engagements.

This product describes a service organization engagement performed in accordance with SSAE No. 16 (AT 801), *Reporting on Controls at a Service Organization*, and provides practice aids that can be used by service auditors in providing that service. It does not discuss the responsibilities of user entity auditors; however, those matters are described in *PPC's Guide to Audits of Nonpublic Companies*. The AICPA has coined the term *service organization control (SOC) reports* to refer to three types of engagements that involve examining and reporting on internal controls at a service organization. An engagement performed under SSAE No. 16 (AT 801) is also referred to as a *SOC 1 report* or *SOC 1 engagement*. In addition, "Other Internal Control Services" in the "Professional Standards" section of this Appendix discusses two additional types of service organization engagements, that are performed under AT 101 , which were christened SOC 2 and 3 reports or engagements. Those engagements are outside the scope of these *Practice Aids*. *PPC's Practice Aids for Reporting on Controls of Service Organizations—SOC 2 Engagements*, which will be released in summer 2015, provides guidance and practice aids when performing SOC 2 engagements. The SOC 2 practice aids can be ordered by calling (800) 431-9025 or from the PPC website at **tax.thomsonreuters.com**. In addition, *PPC's Guide to Nontraditional Engagements* provides an overview of SOC 2 and SOC 3 engagements.

Practice Aids

This Appendix discusses some of the practice aids the authors have prepared to assist service auditors in performing SSAE No. 16 (SOC 1) engagements. Among the other practice aids included in this PPC *Practice Aid* product are illustrations of Type 1 and 2 reports for SSAE No. 16 (SOC 1) engagements and illustrations of control objectives, control activities, and tests of operating effectiveness for various types of service organizations.

Terminology and Glossary

A *SOC 1 engagement* is an engagement on controls at a service organization that are likely to be relevant to user entities' internal control over financial reporting, resulting in either a Type 1 or Type 2 report. The engagement may also be referred to as an SSAE No. 16 engagement, an AT 801 engagement, a SOC 1 engagement, or a service organization engagement. These *Practice Aids* generally use the term *SOC 1 engagement* to provide clarity on the nature of the engagement. References to professional standards in this *Guide* are generally to AT 801 instead of SSAE No. 16.

A glossary of selected terms used in SOC 1 engagements is provided at the end of this appendix.

References to Auditing Standards

While these *Practice Aids* have been developed based on attestation standards (AT 801) instead of auditing standards, AT 801 sometimes refers the service auditor to an auditing standard for guidance in specific situations that may be encountered during a SOC 1 engagement. As an example, AT 801.25 states that when a service auditor determines that sampling is appropriate, the service auditor should apply the requirements in AU-C 530, Audit Sampling . Therefore, in situations in which AT 801 (or the accompanying AICPA SOC 1 Guide) refers service auditors to an auditing standard, the authors have updated the guidance in these *Practice Aids* with the requirements in the appropriate auditing standards.

Clarified Attestation Standards

The Attestation Recodification Task Force of the AICPA's Auditing Standards Board (ASB) has a project to redraft the attestation standards to apply drafting conventions similar to those used in the recently issued clarified auditing standards. In addition, the Task Force will evaluate whether and how to converge the attestation standards with the International Standards on Assurance Engagements. As a result of the project, the ASB issued three exposure drafts of proposed SSAEs: one in July 2013 that would supersede AT sections 20–201 , another in January 2014 that would supersede AT sections 301 , 401 , and 601 , and a final exposure draft in September 2014 that would supersede AT 801 . Additional information about the issues and status relating to AT 801 is discussed in the following paragraphs.

AT 801 Clarity Issues and Status. When AT 801 was issued in April 2010 as SSAE No. 16, *Reporting on Controls at a Service Organization*, it was issued in clarity format since convergence with International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*, was part of the project leading to the issuance of SSAE No. 16. As part of the attestation clarity project, the ASB plans to further clarify AT 801 to align it with the proposed structure of the attestation standards presented in the July 2013 exposure draft, *Attestation Standards: Clarification and Recodification*. Under the project, subject matter-specific chapters, such as chapter 8 relating to AT 801 , will further build on chapters 1–4. [Chapter 1, "Concepts Common to All Attestation Engagements," would cover the requirements and guidance applicable to any attestation engagement; and separate chapters for examination, review, and agreed-upon procedures engagements (chapters 2, 3, and 4, respectively)], would build on the common concepts chapter and include performance and reporting requirements and application guidance tailored to the specific level of service.] Under the clarified format, the subject matter-specific chapters would not repeat requirements and guidance included in chapters 1–4 unless there was a need to tailor such requirements and guidance to address the subject matter.

Although a draft of the chapter addressing AT 801 was presented to the ASB at its October 2013 meeting and the ASB initially recommended that certain changes be made to the draft and voted to ballot it for exposure, the Audit Issues Task Force decided in December 2013 that the clarified chapter on AT 801 should be excluded from the January 2014 subject matter exposure draft. This delay would give the AICPA's Service Organizations Task Force additional time to reconsider the draft and (1) make certain revisions to better align the draft with the application guidance in the May 2013 issue of the AICPA SOC 1 Guide, and (2) address issues encountered in practice.

In September 2014, the ASB issued an exposure draft of proposed guidance, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting: Clarification and Recodification*, that would supersede AT 801 . That document presents many proposed changes to the current standard, some of which include the following:

- Guidance relating to the use of the internal audit function that is not specific to a service organization engagement is deleted. The proposed examination guidance in Chapter 2 of the planned new attestation standard is expected to present the general requirements when using the work of the internal audit function.
- Requires the service auditor to evaluate whether the criteria in management's assertion addresses minimum prescribed matters.
- The service auditor's risk assessment process would require reading relevant reports of the internal audit function and regulatory examinations. In addition, the proposed guidance clarifies how a risk assessment is performed.
- The term *controls at a subservice organization* is replaced with the term *complementary subservice organization controls*
- The phrase "in all material respects" is eliminated from management's assertions about its description, the suitability of the design of controls, and operating effectiveness of controls.
- While management's assertion may still be included in its description of the service organization's system, it must be clearly segregated.
- The term *complementary user entity controls* would apply only to those controls necessary to achieve the control objectives stated in management's description.
- New illustrative reporting language for Type 1 and Type 2 reports.
- Appendix B of extant AT 801 is deleted as illustrative modified service auditor's reports are included in the AICPA SOC 1 Guide.
- Appendix C of extant AT 801 is deleted as illustrative reporting language is presented in Exhibit A and in Appendix A of the AICPA SOC 1 Guide.

As of the date of these *Practice Aids*, the effective date for the new standards has not been announced; however, discussions at the ASB's May 2015 meeting indicate that the expected effective date will be for reports for periods ending on or after May 1, 2017. Future editions of these *Practice Aids* will update the status of this proposed guidance. Practitioners can monitor the progress of the project at **www.aicpa.org/interestareas/frc/auditattest/pages/attestclarityproject.aspx**.