

# What Service Organizations Need to Know About the New SSAE 16 Requirements

By George F. Wiegand Jr., CPA, CISA, and Arshad Ahmed, CPA, CISA

Major changes have been announced to the reporting requirements for service organizations, and as a result many companies will have to devote additional time and resources to compliance. Senior executives may believe they have ample time to prepare, but the deadline for adopting the new requirements is approaching fast. By taking steps now to understand the impact of the changes, companies can proceed in a cost-effective manner and with minimal disruption.

Auditors of service organizations (service auditors) have found guidance in Statement on Auditing Standards No. 70 (SAS 70), "Reports on the Processing of Transactions by Service Organizations," since the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued the standard in April 1992. Many service organizations – third-party vendors such as data processors, third-party administrators, and fulfillment houses – obtained SAS 70 reports, which include an audit opinion, description of controls, a detailed section on how the auditor tested the controls, and a listing of controls that the service organization should have in place. For user organizations (the customers of the service organizations) and their auditors, this documentation has served as a vital resource for verifying the effectiveness of a service organization's controls.

The ASB has been moving toward converging its standards with those of the International Auditing and Assurance Standards Board (IAASB). As part of this shift, the ASB has issued Statement on Standards for Attestation Engagements No. 16 (SSAE 16), "Reporting on Controls at a Service Organization."<sup>1</sup> This standard is closely aligned with International Standard on Assurance Engagements (ISAE) No. 3402, "Assurance Reports on Controls at a Service Organization," which the IAASB approved in September 2009.

When the ASB brought its standards closer to those of the IAASB, it signaled the end of SAS 70 reports. The board issued SSAE 16 in April 2010 to give service organizations time to begin preparing for it. The changes will apply to reporting periods ending on or after June 15, 2011, with an option for early adoption. As a result, many companies will



need to submit required documentation by fall 2010. If a company has a one-year report ending on Aug. 31, 2011, for instance, it must satisfy some initial, labor-intensive requirements by Sept. 1, 2010. Even if not affected until next year, a service organization would be wise to make preparations now to help ensure a smooth transition to the new standard.

## Major Differences Between SAS 70 and SSAE 16

Many of the processes that service organizations put in place for SAS 70 will remain largely the same. However, SSAE 16 does contain some substantive changes that will have far-reaching implications for service organizations. To address these items, a company will need to commit resources to planning and coordination, particularly during the transition period to the new standard.

### The Management Assertion

The most significant change is the addition of a management assertion that covers the full reporting period. The assertion is analogous to the review and approval that a CEO and CFO must provide for a company's financial statements under Section 302 of the *Sarbanes-Oxley Act*. The management assertion has a much higher burden of verification for organizations than the SAS 70 had and consists of several components:

- A fair presentation of the description of the service organization's system;
- An explanation of the suitability of the design of controls;
- Information about the operating effectiveness of controls for the time frame of the report (required only for a Type 2 report);
- A confirmation that management's description of the service organization's system was designed and implemented as of the date of the assertion.

In addition, management must prepare the following items to support the assertion:

- A framework that outlines the basis for the assertion, such as ongoing monitoring activities or other testing such as that conducted by internal audit; and
- Identification of the risks that might prevent a control objective from being achieved.

Organizations could face complications arising from a number of factors.

**Timing.** Because SSAE 16 requires that the service auditor issue an opinion covering the design and effectiveness over the entire time frame of the report,

it is reasonably implied that management's assertion must be available at the start of the audit period. In most cases, the service auditor will find the management assertion very helpful for conducting the audit efficiently. In addition, elements such as the summary of systems and formal definition of the control objectives would be prerequisites for the service

auditor to begin his or her work. Since the opinion will cover the design over the entire time frame of the report, the service auditor likely will need to conduct some work at or near the beginning of the reporting period's start date. Most companies will need to commit significant resources to complete the management assertion prior to the start

### To Do Before the Start Date of the First SSAE 16 Report

#### Establish the framework and basis for providing management's assertion – a task that includes:

- Mapping controls and control objectives to monitoring and testing activities;
- Ensuring any gaps are closed by designing new monitoring activities or testing by management, internal audit, or others; and
- Implementing a methodology to capture significant changes in the summary of systems and obtain the external auditor's agreement.

#### On or near the start date of the reporting period:

- Define the scope of the report (the systems, processes, and services it will cover);
- Determine and document the control objectives;
- Engage a firm to perform an external audit under SSAE 16;
- Provide the scope and control objectives to the external auditor;
- Provide the management assertion to the external auditor; and
- Provide a summary of systems to the external auditor.

#### Throughout the reporting period:

- Report any system changes to the external auditor;
- Continue with validation of controls through monitoring activities or other testing;
- Consider changes in scope only if there is a "reasonable basis" for the change; and
- Coordinate and support the auditor's fieldwork process and requests.

#### On the end date of the reporting period:

- Resolve any open items from the external auditor's testing;
- Provide a signed management representation letter to the service auditor confirming, among other requirements, the management assertion;
- Review drafts and finalize the report; and
- Support any subsequent work by the auditor.

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date of the audit period. In addition, management must reaffirm the assertion with the service auditor in writing when the engagement is concluded.

**Identification of the basis for the assertion.** One of the more time-consuming requirements, particularly for smaller businesses, will be articulating the basis for their assertions – that is, gathering the supporting documentation and evidence to support the company's claims. This process could involve monitoring controls over a period of time or gathering other forms of evidence through internal audits, management testing, and customer feedback.

**Organizational turnover.** When a significant change in the service organization's management has occurred or the service auditor has been selected by a party other than management, executives may be unwilling to approve and sign the assertion. Since the auditor can't begin fieldwork until the assertion has been provided, the company must identify and select another executive to fulfill this obligation.

**Identification of risks.** Furthermore, the service organization's management will need to identify the risks that prevent the achievement of the stated control objectives. As a conclusion to this procedure, the service organization's management needs to be able to determine if the controls as described in the report provide reasonable assurance that the identified risks will not prevent the control objectives from being achieved. Further, management must share their identification of risk with their service auditor. For service organizations that have not been subject to the Sarbanes-Oxley requirements,

identifying and documenting the risks associated with each control could be a time-consuming and costly task.

**Explicit endorsement of assertion by management.** While senior executives, by having to provide a written assertion, will be more involved with setting the scope of the report, they will also have to acknowledge explicitly their responsibilities for the matters addressed in the assertions. Since this statement will be included in the final report, few leaders will be willing to provide their written approval without being confident that the process has provided reasonable grounds supported by rigorous analysis.

**Other Substantive Differences** Although the management assertion is by far SSAE 16's most sweeping and challenging requirement, companies should be aware of other substantive changes.

**Description of the service organization's system.** The new standard has raised the level of detail companies must provide about their control systems. For SAS 70 reports, service organizations had to simply submit a "description of controls" to the service auditor. Now, however, they must provide a description of the entire system as it has been designed and implemented. SSAE 16 defines the "system" as "policies and procedures designed, implemented, and documented by management of the service organization" and includes infrastructure, software, people, and data. A reader of the SSAE 16 report should be able to follow how each transaction the service organization processes on behalf of its customers

is initiated, recorded, approved, and posted. The description also addresses any processes related to transaction reporting and how errors and significant events are identified and handled.

**Assertion requirements for subservice organizations.** Many service organizations use third-party vendors, referred to as "subservice organizations," themselves. Under SAS 70, these companies could provide informal verification. With SSAE 16, however, if a service organization's description includes a third party's control objectives and relevant controls, the subservice organization must submit a written assertion as part of the service organization's report. Since many smaller third-party vendors don't have the resources to prepare an assertion, service organizations might have difficulty obtaining them without a strong relationship or contractual agreement. Therefore, companies must undertake careful planning and coordination with subservice organizations to fulfill this requirement.

**Changes during the reporting time frame.** The service organization and auditor must agree on the scope and time frame of the report at the beginning of the engagement. SSAE 16 requires a reasonable basis to modify the scope or the period that the report covers. A sale or purchase of a division that is significant to the controls and control objectives, for example, may be considered a reasonable basis for altering the report's scope or time frame. Service organizations should consult with an experienced auditor to understand the full range of exceptions.

## How to Prepare

Many service organizations have little time before the start of their next reporting period. Since the SSAE 16 changes need to be communicated across the organization and to third-party vendors, time is of the essence. Once a company identifies the start date of the next reporting period, senior management should take the following steps to ensure a seamless transition.

**Line up the necessary resources.** At a time when many organizations have already reduced their work force, they will need to arrange in short order the additional capacity to handle the greater workload compliance now requires.

**Perform a gap analysis.** The service organization should compare the tested controls included in its current SAS 70 report with the monitoring activities and other testing the organization may already have done to serve as the basis for the management assertion. This analysis will position the company to address issues that may emerge during the auditing period.

**Educate subservice organizations.** Service organizations that use third-party vendors should contact them immediately to educate them on the new requirements and coordinate the preparation of management assertions. This documentation will need to be provided to the auditor at the outset of the reporting period.

### Why Change the Standards?

While SAS 70 had become the de facto international standard for reporting on the effectiveness of service organizations' internal controls over financial reporting, recent trends led to updating the reporting standards: the increase in the number of global business process outsourcers; a greater emphasis on effective controls and reporting processes, especially as a result of the recent economic recession; and a desire to conform to international standards. The ASB's issuance of SSAE 16 in April 2010 was designed to give service organizations time to prepare for the transition.

## Take Action Now

Companies that have been subject to Sarbanes-Oxley, the Model Audit Rule, or other similar controls-based audits and reporting requirements might require less guidance than others, but even companies that currently apply well-established processes to their own financial reporting should begin immediately to apply them to the services and systems covered in their current SAS 70 reports. Whether or not a service organization is familiar with such standards, it needs to get up to speed quickly and begin preparing for the new requirements. The costs of delaying are too great to ignore.

## Contact Information

George Wiegand is with Crowe Horwath LLP in the Indianapolis office. He can be reached at 317.706.2665 or [george.wiegand@crowehorwath.com](mailto:george.wiegand@crowehorwath.com).

Arshad Ahmed is a partner with Crowe Horwath LLP in the South Bend, Ind., office. He can be reached at 574.236.7602 or [arshad.ahmed@crowehorwath.com](mailto:arshad.ahmed@crowehorwath.com).

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<sup>1</sup> For a summary of the provisions of SSAE 16, see [www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/DownloadableDocuments/RecentlyIssuedSSAEs/SSAE%2016\\_Summary.pdf](http://www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/DownloadableDocuments/RecentlyIssuedSSAEs/SSAE%2016_Summary.pdf). A copy of SSAE 16 can be purchased from AICPA's online bookstore at [www.cpa2biz.com/AST/Main/CPA2BIZ\\_Primary/AuditAttest/Standards/SSAEs/PRDOVR-PC-023035/PC-023035.jsp](http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/AuditAttest/Standards/SSAEs/PRDOVR-PC-023035/PC-023035.jsp).