CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Audit and Assurance Alert

CANADIAN STANDARD ON ASSURANCE ENGAGEMENTS (CSAE)

MAY 2020

STANDARDS DISCUSSED

CSAE 3000, *Attestation Engagements Other than Audits or Reviews of Historical Financial Information*

CSAE 3416, *Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting*[1]

FAQs – SOC 1 and SOC 2 Issues Arising From COVID-19

What You Need to Know

This *Audit and Assurance Alert* (*Alert*) is being issued to raise practitioners' awareness of issues arising from COVID-19 related to performing the following engagements:

- System and organization controls (SOC) 1: Reporting on controls at a service organization relevant to the user entities' financial statements
- System and organization controls (SOC) 2: Reporting on controls at a service organization relevant to security, availability, processing integrity, confidentiality and privacy

1 CSAE 3416, *Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting* is effective for periods ending Sept 15, 2020 with early adoption permitted. To the extent that practitioners are using the extant CSAE 3416, *Reporting on Controls at a Service Organization*, in advance of the revised standard's effective date, practitioners should consider the impact to the guidance included in this publication.

What are the key challenges you should be aware of?

The American Institute of Certified Public Accountants (AICPA) has prepared a list of representative frequently asked questions (FAQs) and topics to aid practitioners as they perform SOC 1 and SOC 2 engagements in these uncertain times. It provides non-authoritative guidance to practitioners and may be updated as further questions arise.

The guidance below has been adapted from the AICPA guidance to reflect Canadian standards and terminology.

Understanding Changes to a Service Organization's Operations, Systems and System Controls due to COVID-19

What are important considerations for service auditors planning their SOC engagements in 2020?

One of the most important considerations for service auditors relates to understanding the impact of the COVID-19 pandemic on the service organization's operations, the system used to provide services to customers, and the controls within the system. To a large extent, the effect of the pandemic depends on the nature of the services provided by the service organization, the systems used to provide them, and the controls the service organization has designed and implemented. For example, a service organization that provides post-sales customer support telephonically or a processor of health care claims may have sent personnel home to work remotely. Or, they may have had to lay off or furlough a number of personnel. When personnel with the competence and authority to review, supervise, or perform controls have also been replaced by those that do not, there is an increased risk that controls may not operate effectively as designed. Controls may also be negatively impacted by the lack of direct supervision by senior management.

When there are significant changes to systems and controls, management is responsible for identifying and assessing new risks that might arise from system changes; it is also responsible for making modifications to controls – or designing and implementing new controls – to mitigate assessed risks. A new risk, for example, might result from the introduction of remote access software to enable employees to work from home. It is important that the service auditor carefully discuss with management all changes to the organization's operations, systems, and controls to make sure all relevant risks have been identified and addressed.

When there are significant changes to the system to deal with changes arising from the pandemic, a service auditor who performed a risk assessment prior to the pandemic may need to reassess risks. The service auditor may also have to design and perform different procedures, vary the timing of planned procedures, or perform further procedures in response to the reassessed risks.

For other service organizations, however, the pandemic may have had little impact on their business operations, systems, and controls. In some cases, a service organization – even one that has a heavy degree of human interaction – may have already had procedures in place to

accommodate employees working remotely. Or, the services provided by the service organization may be largely automated and rely very little on human interaction. For example, a service organization that provides IT outsourcing services to customers, or a service organization that provides a Software-as-a-Service (SaaS) solution, may have personnel working remotely who can easily monitor the application systems and related functions that support customers' IT activities, such as network, production, security, change management, hardware, and environmental control activities. In those situations, the pandemic may have had little impact on the service organization, and the SOC engagement may be able to proceed as initially planned.

Regardless of whether the service organization has been impacted by the pandemic, the service auditor's responsibility to obtain sufficient and appropriate evidence to support the opinion in the SOC engagement remains unchanged. The service auditor is still responsible for complying with applicable standards set out in the *CPA Canada Handbook – Assurance* and for exercising appropriate professional skepticism while doing so.

COVID-19-Related Disclosures in the Description of the Service Organization's System

Is the description of the system required to include disclosures about the effect of COVID-19 on the service organization?

For each type of SOC engagement, description criteria describe the types of disclosures to be included in management's description of the service organization's system. Management uses the description criteria when determining what to disclose in the description; the service auditor uses the description criteria when evaluating whether the description is in accordance with those criteria. Management also makes an assertion about whether the description is in accordance with the criteria, and the service auditor issues an opinion on the description.

If the SOC engagement is a type 2 engagement, the description criteria call for the description of the system to disclose relevant details of significant changes to the service organization's operations, system, or system controls.

The service auditor needs to obtain sufficient appropriate evidence about the design and implementation of controls (both before and after the impact of COVID-19, as appropriate) to support the opinion about whether the description is in accordance with the description criteria.

Performing Procedures Remotely

What matters may service auditors consider when determining whether they can perform a SOC engagement remotely?

One of the preconditions in CSAE 3000 is that an auditor expects to be able to obtain the evidence needed to support the practitioner's conclusion. One important aspect of this expectation is whether, amid social distancing, working remotely, and travel restrictions, the service auditor will have access to all relevant information, including any additional information that the practitioner may request, and access to appropriate personnel within the organization.

If the service organization's employees are working remotely, the service auditor needs to consider whether sufficient appropriate evidence is likely to be available to support the opinions in a SOC report (description of the system, suitability of design and, in a type 2 engagement, the operating effectiveness of controls). If the service auditor believes accessing relevant documentation may be problematic, the service auditor may wish to discuss with senior management the need to delay the SOC engagement until operations resume. Depending on the circumstances, the lack of a SOC report or expected delays in its issuance could have ramifications for the service organization's customers (for example, the lack of a SOC 1 report may impact the user auditor's opinion on the user entity's financial statements). For that reason, the service auditor may want to encourage management to discuss the matter with their customers as soon as possible, particularly in situations in which the service organization has made a commitment to provide customers with a SOC report by a certain date.

In other situations, the social distancing restrictions may have little effect on the service auditor's access to records. For example, even if service organization personnel are working remotely, they may still be able to upload relevant documentation to a secure portal to which the service auditor has access. Depending on how the information is obtained from the service organization, the standards require the service auditor to evaluate whether the information is sufficiently reliable for the engagement, which may include evaluating the completeness and accuracy of that information. Although the nature, timing, and extent of procedures may vary depending on the importance of the information or the related control, such procedures may include observation of controls performed; inspection of relevant reports or lists; and, walkthroughs of related processes and controls. Although the service auditor is not responsible for authenticating the documents themselves, the service auditor needs to exercise professional skepticism when considering their reliability as evidence.

The service auditor may also consider the use of video conferencing or transmission technologies to make certain observations related to the implementation and operating effectiveness of controls (for example, to observe physical access controls at a data centre). Such technologies may also be used to perform inquiries of appropriate personnel (for example, when obtaining an understanding of the system and related system controls, both before and after the impact of COVID-19, as applicable). Combined with the inspection of relevant documents, records, or electronic files, procedures such as these may enable the service auditor to confirm that the controls that were in operation

during the prior period are also in place in the current period, or to understand how changes in the system since the prior period were designed and implemented. Incorporating unpredictability into the observations performed through video conferencing (for example, by waiting until the last minute to schedule a video tour of the physical data centre) may be a way to enhance the persuasiveness of the evidence obtained.

In some situations, making inquiries using video conferencing technologies may be more effective than making them on a simple telephone call (for example, when making inquiries related to fraud, since the service auditor may be able to see the individual's body language). Determining whether sufficient appropriate evidence has been obtained to support the service auditor's opinion is a matter of professional judgment; the inability to obtain sufficient appropriate evidence may lead to a modification of the service auditor's opinion because of a scope limitation.

The service auditor needs to carefully document all procedures performed to demonstrate that the requirements of the standards were met, particularly since the procedures may differ from those performed before social distancing restrictions were in place.

Going Concern Issues

Do service auditors have any responsibility in SOC engagements for going concern issues of the service organization arising from COVID-19?

Service auditors have no responsibility to perform procedures in a SOC engagement to determine whether the service organization can continue as a going concern. However, while performing the SOC engagement, the service auditor may become aware, from discussions with senior management or the service organization's financial statement auditor, that the service organization's ability to stay afloat has been impacted by the pandemic. In this situation, management needs to consider whether additional disclosures are needed in description of the system.

If management adds additional disclosures about the effect of the COVID-19 pandemic on its ability to remain in business, the service auditor may also consider whether to include an additional paragraph in the service auditor's report to draw users' attention to such disclosures.

Depending on the timing of the engagement, concerns about the service organization's ability to continue in business may have arisen after the specified date or period of time addressed by the SOC engagement. If disclosures made in the description of the system are not affected, management and the service auditor may consider whether disclosure as a subsequent event may be appropriate.

Subsequent Events

Should service auditors consider the need for subsequent events disclosures related to COVID-19 in SOC engagements?

The standards require the service auditor to inquire of management (and if different, the engaging party) about whether it is aware of any events or transactions subsequent to the specified period or period of time covered by the engagement up to the date of the service auditor's report. In these circumstances, the service auditor needs to obtain evidence about the effects of those events on the service organization's systems and related controls.

Sometimes, disclosure of such events and transactions may be necessary to prevent report users from being misled. Management may make such disclosures in the "Other Information" section of the SOC report. The service auditor may consider whether to emphasize those effects by adding an additional paragraph to the service auditor's report.

Management Representation Letters

Should service auditors request additional representations related to COVID-19 in the management representation letter?

During this pandemic, the service auditor may consider asking service organization management to make additional representations in the representation letter, depending upon the particular circumstances of the SOC engagement. Those additional representations may relate to any of the following:

- effects of COVID-19 on the service organization, its operations, and technologies used in providing services
- any communications to customers and business partners about changes in service level agreements or commitments
- disclosure of all changes to systems and related controls due to COVID-19
- identification and assessment of new risks arising from changes to systems and related controls
- any concerns related to going concern (see question above)
- reasons for changing from the use of inclusive method to the carve-out method for subservice organizations

Subservice Organizations

How might COVID-19 affect a service organization's disclosures surrounding the use of subservice organizations?

During this period, it is more important than ever that a service organization assess the risks of doing business with subservice organizations. Depending on the services performed by the subservice organization, financial instability, temporary closure, or furloughed staff can negatively impact the service organization's ability to meet its commitments to customers and business partners.

When the inclusive method has been used in the past to disclose, in the description of the system, the services provided by a subservice organization, the service auditor needs to discuss with management the subservice organization's continued willingness to participate in the engagement. Some subservice organizations may be overwhelmed by the current situation and may not have the time or resources to participate as a responsible party in the SOC engagement. In that situation, senior management may have no choice but to change from the use of the inclusive method to the carve-out method.

When the subservice organization's services and controls are likely to have a pervasive effect on the service organization's system, management and the service auditor need to consider whether the use of the carve-out method may result in a presentation that is not useful to customers and business partners. In that situation, management and the service auditor may consider the need to modify management's statement and the service auditors' report, respectively, because of the scope limitation.

The sooner the service auditor identifies any potential issues surrounding the use of subservice organizations in a SOC 1 engagement, the sooner management or the service auditor can communicate that information to its customers and user auditors of the entity's financial statements.

What additional resources are available to help you?

- CPA Canada – *COVID-19: Resources related to reporting and audit*
- AICPA – *FAQs: Audit Matters and Auditor Reporting Issues Related to COVID-19*
- CPA Canada SOC 1 Guide – *Reporting on Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*
- CPA Canada SOC 2 Guide – *Reporting on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality, or Privacy*

Feedback

Comments on this *Audit & Assurance Alert*, or suggestions for future *Alerts* should be sent to:

Yasmine Hakimpour, CPA, CA
Principal
Audit & Assurance
Research, Guidance and Support
Chartered Professional Accountants of Canada
277 Wellington Street West
Toronto ON M5V 3H2
Email: yhakimpour@cpacanada.ca