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A Primer in SAS 70 Reports

by Steven L. Schmidt

The American Institute of Certified Public Accountants' Statement on Auditing Standards (SAS) No. 70 is an internationally recognized auditing standard for service organizations. A SAS 70 audit report demonstrates that a service provider has been subjected to a thorough audit of its internal control activities, including controls over information technology and related processes.

Service providers and third party administrators have found that obtaining a SAS 70 report is an effective way to establish credibility with potential customers. Specifically, a "clean" (no reported internal control deficiencies) SAS 70 report communicates that the service organization has effective internal controls in place. A SAS 70 report acts as a selling tool for the organization as it can differentiate a service provider from its competitors. The SAS 70 audit process can also be utilized by management as a way to identify opportunities for improvement in operational areas.

The major difference between the two types, as noted in the table below, is the Type I SAS 70 audit report does not include a test of operating effectiveness of the internal controls in place at the service organization. Whereas, a Type II SAS 70 audit report includes tests of operating effectiveness of the internal controls in place at the service organization and identifies any known weaknesses that may exist.

The Type I SAS 70 audit report is a good starting point for service organizations reporting for the first time. This audit gives them the opportunity to identify and remediate any internal control weaknesses prior to reporting on their effectiveness. The drawback to the Type I audit report is that many external auditors may still need to test controls in place at the service organization in order for them to gain assurance that the controls are operating as designed.

An added benefit of a Type II SAS 70 audit report is that if the report is "clean," an auditor of a company utilizing the service provider's services can use the SAS 70

report to reduce the amount of testing it must perform. In most instances the customer's auditor will not be required to visit and perform tests at the service provider's place of business. Without a current Type II SAS 70 report, a service organization may have to respond to multiple audit requests from its customers and their respective auditors. Multiple visits from customer auditors can be inconvenient and expensive, as they place a strain on the service organization's personnel. SAS 70 reports have become increasingly important and necessary as public company clients of service providers become subject to the requirements of the Sarbanes-Oxley Act of 2002. Also in today's environment, companies continue to outsource the processing of internal information to service organizations. Therefore, greater reliance is being placed on service organizations and as a result there has been an increase in the number of SAS 70 reports being required by companies to verify the accuracy, completeness and security of this processed information.

A Type I SAS 70 is generally at a point in time (e.g., October 31, 20xx), and a Type II SAS 70 covers a specified period of time (e.g., November 1, 20xx to October 31, 20xx). The Type II SAS 70 reporting period typically covers at least a six-month period of time and provides some flexibility since the period can be established at any time throughout the service provider's fiscal year. In situations when a reporting period does not coincide with the fiscal year end of a service provider, a Gap Letter can be issued. A Gap Letter is very common and states that to the best of your knowledge, there have not been any significant changes in the internal

There are essentially two types of SAS 70 reports; Type I and Type II:

Report Contents	Type I Report	Type II Report
1. Independent service auditor report	Included	Included
2. Service organization's description of controls	Included	Included
3. Information provided by the independent service auditor; includes a description of the service auditor's test of operating effectiveness and the results of the test	Optional	Included
4. Other information provided by the service organization	Optional	Optional


controls described in the SAS 70 report since it was issued for the period ending October 31, 20xx, nor are there any material weaknesses in such internal controls and procedures that require any corrective action. The service auditor conducts a full and complete audit each year and reports on the results even if the description of controls remain the same for the service organization.

The service organization's description of controls should be developed utilizing the following five interrelated components of internal controls as outlined in COSO (Committee of Sponsoring Organizations of the Treadway Commission):

- Control environment;
- Risk assessment;
- Control activities;
- Information and communication; and
- Monitoring.

Also, there are additional external control considerations that are embodied as part of a SAS 70 report. In certain situations, the application of specific controls at a respective client organization is necessary to achieve certain control objectives

in a service organization's SAS 70 report. These are identified as user controls. Typically, client auditors should consider whether these user controls have been placed in operation at client organizations and test them accordingly.

It is not uncommon and, in fact, usually a good practice, for a service provider to initially obtain a Type I SAS 70 report to identify and remediate any internal control deficiencies prior to having the internal controls tested as required in a Type II SAS 70 engagement. 



Steven L. Schmidt is an associate director in the assurance services department of the SS&G Akron office. Steve has 20 years of experience in accounting in both the public and private sectors. His expertise includes audits of small to mid-sized manufacturing companies, companies in the service industry, retailers, distributors, government agencies and nonprofit organizations. He is experienced with compliance requirements of federal, state and local governments, as well as Sarbanes-Oxley 404 compliance implementation projects, particularly in the areas of identification and documentation of key processes and controls. Steve also specializes in SAS 70 engagements. Steve was awarded the "Governmental/Not-for-Profit Accounting and Auditing Certificate of Educational Achievement" from the AICPA. (SSchmidt@SSandG.com)