

Mark Babington
Financial Reporting Council
8th Floor – 125 London Wall
London EC2Y 5AS

31 July 2015

Dear Mr Babington

Consultation on a new Assurance Standard: Providing Assurance on Client Assets to the Financial Conduct Authority

Deloitte LLP is pleased to comment on the consultation paper Providing Assurance on Client Assets to the Financial Conduct Authority published by the Financial Reporting Council ('FRC') on 14 May 2015.

Deloitte is a member firm of the Institute of Chartered Accountants in England and Wales ('ICAEW') and we have contributed to the response paper prepared by the Financial Services Faculty on behalf of the ICAEW regarding the subject above, and we have not sought to duplicate those matters already raised by the ICAEW.

We recognise that the role of the CASS auditor is important in supporting the objectives of the FCA's client assets regime, and therefore are very supportive and appreciative of the FRC's effort to develop a Standard in respect of providing assurance on client assets to the FCA. We would like to take this opportunity to reiterate that the primary responsibility to comply with the FCA's CASS rules lies primarily with the firm. The FCA also has a duty to fulfil its statutory objectives in order to guard against systemic failure of the CASS regime. The role of a CASS auditor cannot be perceived to replace or supersede those of the firm and the FCA.

Overall, we have concerns that the proposed Standard does not achieve the objectives as set out by the FRC. We set out in the Appendix to this letter our detailed response to each of the eight specific questions raised in the consultation paper. In summary, we are concerned that:

- There is a general lack of specific guidance, inconsistent use of terminology and unclear descriptions used in the Standard. This will not drive consistency across all CASS auditors in terms of approach and the level of work that is carried out and as a result, the FCA may receive an inconsistent level of assurance from firms' CASS auditor's reports.
- A significant amount of useful material from the current FRC Bulletins (2011/2 and 3) are not included in the Standard, for example, the guidance on factors to be considered when providing reasonable assurance in Appendix 1 of Bulletin 2011/2, or is located in the Contextual Material section

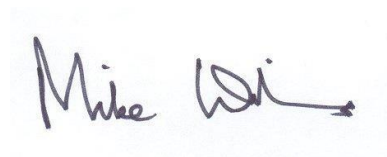
accompanying the proposed Standard. Including these useful materials into the Standard would help drive a consistent approach when providing assurance on client assets to the FCA.

We note that the FCA is still in the process of finalising the new CASS 5A rules following the publication of Consultation Paper 12/20 in August 2012. Whilst the FRC recognises this in paragraph 20 of the Introduction to the consultation, we would welcome the opportunity to provide further feedback to the Standard when the CASS 5A rules are finalised.

Finally, we suggest that the proposed Standard require those applying it to comply with International Standard on Quality Control (UK and Ireland) 1.

We would welcome the opportunity to discuss our responses with the FRC and the FCA in more detail. Should you have any comments or questions please do not hesitate to contact either Mike Williams (mikewilliams@deloitte.co.uk or 020 7303 5407) or Dennis Cheng (dencheng@deloitte.co.uk or 020 7303 6970).

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Mike Williams', with a stylized flourish at the end.

Michael Williams, CASS Partner
Deloitte LLP

Appendix

Detailed responses to questions

Will the proposed Standard achieve its Objectives?

1 Do you believe that the proposed Standard will meet the objectives set out in paragraph 19 of the Introduction and, in particular, improve the quality of client asset assurance engagements? If not, why not?

No. We do not believe that the proposed Standard will meet the objectives set out in paragraph 19 of the Introduction, and our response will address each of the intended objectives as listed in items a to h below:

a. Improve the quality of CASS audits

We do not believe that the proposed Standard will necessarily improve the quality of CASS audits without further improvements to a number of areas of the proposed Standard as set out in our response to Question 4 below.

b. Adequately support and challenge CASS auditors when undertaking CASS engagements and, in particular, to define the nature and extent of the work effort required for both reasonable assurance and limited assurance CASS engagements without undermining the importance of the CASS auditor's judgment;

We support the basic principles underpinning the overall process to undertake a CASS reasonable assurance engagement and to form a reasonable assurance opinion. However, a lack of specific guidance regarding certain key matters, for example the evaluation of the firm's risk assessment and monitoring activities, the exercise of judgement as to whether a breach could be significant, and a general lack of guidance to define the nature and extent of the level of work required may undermine the FRC's intention to publish a Standard that will sufficiently support and challenge the CASS auditors when undertaking CASS engagements. Please see specific comments provided in response to Question 4 below.

c. Support the objectives of the FCA's Client Asset regime regarding the effective safekeeping of client assets and client monies and in particular to guard against systemic failure of the CASS regime;

We believe that the provision of an annual CASS auditor's report to the FCA will assist to support the objectives of the FCA's client asset regime where matters are reported to the FCA's attention, e.g. CASS breaches. However, the CASS auditor's report is only part of the picture. Firms have primary responsibility to comply with all the relevant CASS rules, to ensure adequate systems and controls are implemented to ensure compliance with the CASS rules on an ongoing basis, and to ensure client assets are adequately safeguarded. The FCA also has their responsibility to supervise firms and to guard against systemic failure of the CASS regime in line with its statutory objectives.

- d. *Manage the expectations of:*
- i. *The management of firms that hold client assets; and*
 - ii. *Third party administrators*
- when they engage a practitioner to provide assurance to the FCA on client assets that they handle or account for*

We do not have specific comments relating to this matter.

- e. *Support the effective training of CASS auditors by both the accounting bodies and other training organisations*

Training of CASS auditors on the five specific areas proposed by the Standard in paragraph 36 will support the CASS auditors in understanding those areas. However, the effectiveness of such training to deliver a more consistent approach across different CASS auditors will be limited if the shortcomings of the proposed Standard set out in b above remain unaddressed.

- f. *Help to establish realistic expectations regarding the integrity of the UK Client Asset Regime with the beneficial owners of client assets*

We do not believe that the proposed Standard will address the above stated objective. All assurance engagements have at least three separate parties¹: the practitioner (in this context, the CASS Auditor), the responsible party (in this context, the firm with the responsibility to put in place adequate systems and controls to enable it to comply with the CASS rules); and the intended user (in this context, the FCA). Since the beneficial owners of client assets are not one of the three parties of the assurance engagement, we do not believe that the proposed Standard will help them establish realistic expectations regarding the integrity of the UK Client Asset Regime.

We expect that other means are required to achieve the above stated objective, e.g. communication and educational materials issued by the FCA and / or the FSCS that is relevant to each type of beneficial owners of client assets (retail, professional and eligible counterparty). We also refer back to our comments above regarding the responsibilities of firms and the FCA itself.

In addition, no system of internal control can offer absolute assurance that the underlying control objectives will be met, nor that because a system has operated one way in the past that it will continue to be operated that way in the future. In order to manage users' expectations, we suggest that CASS audit reports clarify this point. Suitable wording, drawing on ISAE 3402², might be: "Because of their nature, controls at the firm may not prevent or detect all errors or omissions in complying with the custody rules, collateral rules, mandate rules and client money rules. Also, the projection of any evaluation of effectiveness to future periods is subject to the risk that the firm's controls may become inadequate or fail."

- g. *Underpin the effectiveness of the FRC's enforcement and disciplinary activities with respect to CASS assurance engagements*

We do not believe that the proposed Standard will meet the above stated objective. As it is currently drafted, there are a number of areas that are left for the CASS engagement leader to exercise his / her professional judgement without sufficient guidance; we have expanded on these areas in our

¹ Reference: Paragraph 27 of the International Framework for Assurance Engagements

² International Standard on Assurance Engagements ('ISAE') No. 3402, Assurance Reports on Controls at a Service Organization

response to question 4 below, for example on the nature, timing and extent of the CASS assurance work and level of testing, and whether a matter is of material significance to the FCA or of sufficient importance to require the attention of the governing body. There are also certain of the FCA's own CASS rules which are open to interpretation which may lead to inconsistent application by CASS auditors; as the requirements of those rules are unclear, it may be hinder the ability of the FRC to carry out enforcement and disciplinary activities. We suggest that the FRC work with the FCA to resolve these issues.

Effective date

2 The proposed Standard is effective for reports to the FCA with respect to client assets covering periods commencing on or after 1 January 2016, with early adoption permitted. Do you believe that it would be appropriate to mandate the application of the Standard for earlier reporting periods to achieve the objectives set out in paragraph 19 for reporting periods commencing before 1 January 2016?

We do not object to the proposed commencement period. However, we do not believe that it would be appropriate to mandate the application of the Standard for earlier reporting periods because accountancy firms carrying out CASS assurance engagements will require sufficient time to prepare and to train the engagement teams of the requirements in the new Standard.

The effective date should also take into account the timing of the publication of the final Standard in order to allow adequate time to prepare and to train the engagement teams. In our view, publication of the final Standard by the end of 2015 will allow accountancy firms time to update forms and tools and provide training before early planning work in mid-2016. If the final standard is not published in 2015 we recommend that the FRC consider deferring the date accordingly.

Content of proposed Standard

3 The proposed Standard includes within a single document requirements relating to:

- a. Reasonable assurance engagements;**
- b. Limited assurance engagements;**
- c. Special reports; and**
- d. Non statutory Client Money Trusts.**

The FRC considered other possible approaches involving issuing a number of separate and shorter Standards. On balance, however, the FRC concluded that including all the requirements in a single document was likely to be the most helpful to practitioners and to mitigate the risk of practitioners, who perform relatively few engagements, from failing to select a relevant Standard to complete. Do you agree with including all requirements in a single Standard? If not, why not and what alternative structure for the Standards would you prefer?

We support the FRC's proposal to include all the requirements in a single document to enable easier referencing. However, the purpose of the contextual material section is unclear. We would recommend that the FRC extract those matters that are relevant and useful to the CASS auditor from the contextual material section and include them as an appendix to the Standard.

However, there is a lack of guidance to support the CASS auditor in issuing an opinion relating to a nominee company in whose name custody assets of the firm are registered during the period. Given the

responsibility of the CASS auditor to opine on this under SUP 3.10.5 R, it would be helpful if there was guidance on this matter.

Proportionality of requirements

4 The proposed Client Asset Assurance Standard contains a combination of requirements (basic principles and essential procedures indicated by paragraphs in bold type) and guidance (application and other explanatory material). Do you consider the extent of the requirements to be proportionate to Client Asset Assurance Engagements which require the CASS auditor to make a direct report to the Financial Conduct Authority rather than reporting on an assertion by management? If not, why not?

Please specify any requirements you believe to be unnecessary and any additional requirements that you believe should be included? In both cases please provide your reasoning.

Limited assurance engagement

There is currently no guidance within the Standard as to how a CASS auditor should report breaches identified from a limited assurance engagement. For example, consider a firm that applies the Banking Exemption under CASS 7.10.16 R and claims not to hold client money which has, however, failed to comply with the notification requirement under CASS 7.10.19 R. Paragraph 164 of the proposed standard does not require a Breaches Schedule to be included for a limited assurance opinion, although paragraph 28 of the contextual material does not distinguish between reasonable and limited assurance engagements when referring to the need for a Breaches Schedule. Guidance on how to report this matter to the FCA could usefully be included within the Standard.

The definition of “*Limited assurance client assets report*” in paragraph 10 of the Standard makes reference to “...*that risk*...”. However, it is unclear what “*that*” relates to. We think that the FRC intends to make reference to the assurance engagement risk.

The phrase “terms specified by the FCA”

The phrase “*terms specified by the FCA*” is used a number of times in the Standard (for example in paragraph 10 where CASS assurance engagement is defined as “*An engagement in which a CASS auditor expresses an opinion,..., in terms specified by the FCA...*”). We would recommend that instead of using this phrase the FRC makes specific reference to the relevant rules in the FCA handbook in order to provide more clarity.

The term “related assertions”

The term “*related assertions*” is used a number of times in the Standard (e.g. in the definition of “*Applicable criteria*” in paragraph 10). Whilst the term “*assertions*” appeared in the original version of ISAE 3000, it does not appear in the revised version applicable from 2015. Although the proposed standard does not explicitly refer to ISAE 3000, the approach is consistent with an attestation engagement where, as contemplated by paragraph 12(a)(ii)(a) of that standard, the assurance practitioner can present the subject matter information in their report rather than referring to a separate assertion by management.

We suggest that:

- the definition of applicable criteria in paragraph 10 be redrafted to include (a)-(d) in paragraph 70 of the proposed Standard and remove references to the related assertions from that paragraph;
- change other references from “*applicable criteria and related assertions*” to “*applicable criteria*” (and, in paragraph 69(a), change “*assertions and related criteria*” to “*applicable criteria*” and in paragraph 69(b) change “*assertions*” to “*applicable criteria*”); and
- include in paragraph 71 a requirement to check the Financial Services Register for any waivers and modifications and to confirm with the client whether they have been issued with any individual guidance.

The term “materially misstated”

The term “*materially misstated*” is used in the definition of “*CASS assurance engagement risk*” in paragraph 10. However, as stated in paragraph 43 of the Contextual Material, materiality is not a relevant consideration. Therefore, we suggest that the words “*when the subject matter information is materially misstated*” to be deleted from the definition.

Breach of CASS rules that could be significant

We think that clarification and guidance is required on what constitutes a “*...breach of the CASS rules that could be significant...*”. This phrase is used a number of times in the Standard, however there is no guidance as to what significant means. We would strongly recommend that the FRC provide more specific guidance in this area. In addition we suggest that the term “*significant breach*” in paragraphs 69(c) and 74 are amended to “*...breach of the CASS rules that could be significant...*” such that the use of terms are consistent throughout the Standard.

Reportable breach

The guidance on whether a CASS rule breach is reportable to the FCA is inconsistently described throughout the Standard. A “*Reportable breach*” is defined in paragraph 10 of the FRC as “*A breach of the FCA’s rules...which may be of material significance to the FCA*”. However, this definition is inconsistent with paragraph 41(b) of the Standard which states: “*the responsibility of the CASS auditor to report to the FCA all breaches of the CASS rules...*”. Paragraph 43 of the Contextual Material states: “*The materiality or significance of a breach of the CASS rules, therefore, are not relevant considerations in determining whether the breach of a CASS rule needs to be reported to the FCA by the CASS auditor.*” and paragraph 118 of the Standard also requires all CASS breaches to be reported to the FCA regardless of materiality. We suggest that, if the intention is that all breaches are to be reported:

- the term “*reportable breach*” in paragraphs 123, 137 of the proposed Standard be replaced with the word “*breach*”;
- in paragraph 43 of the Contextual Material, the final sentence be reworded to read “*... client bank account is a breach and therefore must be reported to the FCA regardless of whether...*”; and
- the definition in paragraph 10 be deleted.

Underlying subject matter

We suggest that that the definition of “*Underlying subject matter*” for a limited assurance client assets report should refer to “*the firm not holding client assets.*” This would be clearer.

CASS 5 insurance intermediaries – non-statutory trusts

We note that the proposed Standard is inconsistent with CASS 5 in relation to what an insurance intermediary must disclose in client agreements in relation to holding money in a non-statutory trust account. Paragraph 181 of the Standard states that an insurance intermediary must “*take reasonable steps to ensure that its terms of business adequately explain the implications to a client of its money being held in a non-statutory trust*”. Currently, under CASS 5.4.4 R (5), an insurance intermediary is only required to explain that money will be held in a non-statutory trust. However, we do note that in the FCA’s Consultation Paper 12/20, CASS 5A.4.7 R (5) states that client agreements must adequately explain the risks posed by using a non-statutory trust. The final Standard may need to be amended if it comes into force before the new CASS 5A rules.

Documentation

Paragraph 43 of the Standard requires the CASS auditor to document all items listed in a. to c. We suggest the addition of a sentence saying “For a small CASS reasonable assurance engagement or a limited assurance engagement the documentation may combine a and b above.”

It is also unclear what the practical distinction is between an overall assurance strategy and an assurance plan. We recommend that the FRC revise this requirement to only include one or the other, and not both.

CASS auditor’s duty to report and right to report to the FCA

Paragraphs 58 to 63 of the Standard describe the circumstances in which the CASS auditor has a duty to report to the FCA. We recommend that the FRC acknowledge in the standard that where the CASS auditor is only appointed to do the CASS audit (for example if the firm is exempt from statutory audit), the range of circumstances of which it become aware and timing of that awareness may be different than for a CASS auditor who is also the statutory auditor of the firm’s financial statements.

Firm’s risk assessment and monitoring activities

Paragraph 85 requires the CASS auditor to obtain an understanding of whether the firm has a process for carrying out a risk assessment for client assets. However, there is a presumption that all firms which are subjected to a CASS reasonable assurance engagement has in place a risk assessment process. If the firm does not have risk assessment process in place, it is unclear the implications on a CASS reasonable assurance engagement since it may not necessarily constitute a CASS breach if the firm has complied with the relevant CASS rules, and has relevant systems, processes and controls in place to enable it to comply with all the applicable CASS rules.

The above comment is also applicable in the context of paragraph 87 of the Standard which requires the CASS auditor to evaluate the firm’s monitoring activities.

Evaluating the design of control activities

We think that the current drafting of paragraph 92 is unclear. It makes reference to the CASS auditor evaluating whether the firm's control activities are likely to provide reasonable assurance of compliance with the relevant CASS rules. The purpose of a control activity is not to provide the firm with reasonable assurance, rather it is designed, implemented and operated by the firm to mitigate a specific risk and / or to enable the firm to comply with specific requirements of the CASS rules. The CASS auditor should evaluate whether the control activities meet its intended control objectives.

It is also unclear why the CASS auditor is required to evaluate whether the firm's system design identifies appropriate control activities. As mentioned above, the CASS auditor should evaluate whether the firm has designed relevant controls to enable it to comply with the relevant CASS rules, which should be the firm's response to the risks identified by the firm as a result of its risk assessment process (as suggested by paragraph 85 of the Standard).

More clarity is required as to what is meant by item c. "the implications of different controls for different parts of the business" and item d. "where appropriate, whether detective controls will be effective within the time periods (if any) permitted by the CASS rules".

Engagement Quality Control Review

5 The proposed Standard requires Engagement Quality Control Review to form an integral part of all reasonable assurance engagements. The FRC is of the view that the CASS engagement leader will typically be required to make a number of important judgments concerning the nature, extent and timing of assurance procedures and that the CASS engagement leader should be subject to engagement quality control review throughout the course of the engagement. Do you agree?

Yes we agree.

Ethical requirements

6 The proposed Standard requires CASS auditors to comply with the FRC Ethical Standards for Auditors (concerning the integrity, objectivity and independence of the auditor) and the ethical pronouncements established by the CASS auditor's professional body. Do you agree with this proposal? Please provide your reasoning whether you agree or disagree with the proposal.

We support the FRC's proposal to require the CASS auditors to comply with the ethical pronouncements established by the CASS auditor's professional body.

However, we do not support the FRC's proposal to extend the application of Ethical Standards for Auditors to the CASS auditor since it is disproportionate to apply this on a CASS assurance engagement which is a non-audit reasonable or limited assurance opinion. In particular, applying the Ethical Standards for Auditors to firms that are exempt from an audit of their statutory financial statements could reduce many smaller regulated firms' choice of CASS auditors or to reduce many regulated firms' choice of CASS auditor to just the statutory auditor. We suggest that the provision be redrafted so that:

- where the CASS auditor is also auditing the financial statements, Ethical Standards apply; or

- where they are not, the relevant independence standards for assurance engagements apply (e.g. Section 291 of both the ICAEW and ACCA Codes of Ethics).

Requirements relating to training of CASS auditors

7 Paragraph 55 of the Contextual Material seeks to explain the implications for the training of CASS auditors of the mind-set required to complete CASS assurance engagements. The mind-set for performing a financial statement audit is different to the mind-set for performing a CASS engagement and, therefore, it may be dangerous to have audit staff perform a CASS engagement absent adequate training. The proposed Standard (see paragraph 36), therefore, includes explicit requirements for the CASS audit team to include staff who have received training in various aspects of CASS audits. Do you agree that the Standard should include requirements for staff training? If not, why not?

We support the FRC's proposal to require the CASS audit team to include staff who have received training in various aspects of CASS audits. The level of training should be proportionate and relevant to the CASS assurance engagement undertaken by the audit staff (e.g. staff undertaking a reasonable assurance engagement vs. staff undertaking a limited assurance engagement).

Communicating deficiencies in internal control to management and the governing body

8 In contrast to an auditor's report on financial statements a reasonable assurance CASS auditor's reports is required (with some exceptions) to include a schedule of Rule Breaches. As a result of this requirement some contend that it is unnecessary for the CASS auditor to report deficiencies in internal control to both management of the firm and the firm's governing body both during the CASS audit and on its completion. The FRC, however, is of the view that matters may come to the CASS auditor's attention which whilst not being Rule Breaches per se are none the less of sufficient import to warrant reporting to both management and the firm's governing body. These requirements are set out in paragraphs 137 to 140 of the proposed Standard. Do you agree with the FRC's approach? If not, why not?

In paragraph 138, the Standard mentions "...deficiencies in internal control... that in the auditor's professional judgment are of sufficient importance to merit management's attention", whilst in paragraph 139, the Standard mentions "significant deficiencies in internal control" (and also defined in paragraph 10) which require communication by the CASS auditor to the firm's governing body.

It is unclear where the practical distinction lies between the two types of deficiencies, i.e. a deficiency that is not significant but is of sufficient importance (as described in paragraph 138), and another which is a significant deficiency (as described in paragraph 139). We would encourage the FRC to include further guidance as to these distinctions to aid the CASS auditor in forming their judgements in these areas.

Due to the way that it is currently drafted in both paragraphs 138 and 139, it could be read to imply that the former does not require the CASS auditor to communicate in writing, whilst the latter require the CASS auditor to communicate in writing, and that the former only merit management's attention whilst the latter require the CASS auditor to inform to the firm's governing body. In our opinion, due to the nature of the deficiencies which are either of sufficient importance or significant, we would expect both types of deficiencies to be communicated in writing, and that they will be communicated to both the management at an appropriate level of responsibility, and also to the firm's governing body. We would recommend that

the FRC revise the drafting of these paragraphs in terms of the method of communication and also the intended recipients.

It is also unclear in paragraph 138 the reasons that the FRC draws out whether or not the internal control deficiency has been communicated to management by other parties – as it does not have a bearing on whether the CASS auditor should then communicate it to the firm if it was identified during the CASS audit. If the intention of the FRC is to state that it is not required for the CASS auditor to communicate these matters to the firm if they have already been communicated by other parties, we would encourage the FRC to make this intention explicitly known in the Standard.

Finally, we suggest that the term “Governing body” be replaced with “Those charged with governance” (and the definition aligned with that used in International Standards on Auditing) throughout the proposed Standard for consistency with ISQC 1 (UK and Ireland) and applicable ethical guidance (whether the FRC’s Ethical Standards or that issued by the relevant professional body).