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Our ref: FRC - CASS FR/RB

Email:
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Dear Mr Babington

FRC Consultation Paper "Providing Assurance on Client Assets to the Financial Conduct Authority" (May 2015)

We welcome the opportunity to comment on the above consultation on a new Assurance Standard (the "Standard") and provide below our responses to the specific questions raised. BDO LLP is an award winning UK member firm of BDO International, the world's fifth largest accountancy network, with more than 1,000 offices in more than 100 countries. One of BDO LLP's Strategic Business Units focuses on offering services to clients that operate in the financial services sector (across Audit, Advisory and Tax). Financial Services Audit principally focuses on externally auditing PRA and FCA regulated entities, along with those unregulated entities operating within this sector.

We are supportive of the introduction of a Standard on CASS assurance engagements and consider it will strengthen the quality of work performed on these engagements. However, we would like to raise three general points of principle.

Our first point concerns proportionality. We strongly advocate a risk based approach to CASS assurance engagements and support the FRC's approach to provide a principles-based approach with the application of professional judgement. We are concerned that the Standard as currently drafted imposes extensive requirements in areas that we consider should be left to professional judgement. These requirements include the expectation of a certain level of infrastructure at professional services firms such as the ability (and we would question whether it is always necessary to) to appoint an engagement quality control reviewer ("EQCR") on all relevant assignments. Whilst this does not affect our position, this could have the unintended consequence of excluding the smaller professional services firms from the market. Please see our response to Question 4 below for further details on this.

Our second point concerns the applicability of this Standard to CASS assurance engagements for insurance intermediaries. The Standard fails to recognise the application of a CASS assurance engagement to the concepts in CASS 5. For instance the Standard does not differentiate between a statutory trust regime and a non-statutory trust regime for insurance intermediaries, or refer to the exemptions available for insurance intermediaries, and in places this Standard refers to bold type requirements that are simply not relevant to insurance intermediaries, such as limited assurance reporting and the Client Money and Asset Return ("CMAR"). Please see our response to Question 3 below for further details on this.

Our final point concerns the FRC's Ethical Standards for Auditors applicable to CASS assurance engagement. We agree with the proposal to require the CASS auditor to comply with the FRC's Ethical Standards, however we question whether this can be applied proportionately. In essence, many FCA regulated entities are small and are akin to closely owned SMEs which do not pose the type of systematic risk to the market posed by larger regulated firms. There is a real concern in relation to the current standards as we consider they might inhibit many of these smaller entities



from obtaining the best advice on a timely basis and we question whether that is in the public interest. We would urge the FRC to consider the proportionality of the application of the existing stricter requirements to such entities.

Our comments and observations to the questions posed in this Consultation are attached in Appendix 1 to this letter. Our comments and observations in relation to specific paragraphs are attached in Appendix 2 to this letter.

If you have any queries in relation to our above response, please contact Fiona Raistrick on 020 7486 5888.

Yours sincerely,

A handwritten signature in purple ink that reads 'BDO LLP.'.

BDO LLP

Appendix 1: BDO LLP Responses to the FRC's questions

Q1: Will the proposed Standard achieve its objectives?

Subject to the matters we raise in the responses to the questions below and in Appendix 2 of this letter, we consider that, the proposed Standard will meet the stated objectives.

Q2: Effective date

We consider that the proposed date of annual periods commencing on or after 1 January 2016 is the earliest possible adoption date for the introduction of a new Standard, as long as the Standard is finalised before 30 September 2015. This is to allow sufficient time for professional services firms to amend their methodologies as necessary, including enhancing documentation requirements, quality control policies, work programmes and to train partners and members of staff involved in CASS assurance engagements on the various matters specified in the Standard. There also needs to be sufficient time to allow CASS assurance teams to plan their work accordingly. This time consuming task should not be underestimated. Theoretically we could see a challenge here for the larger FCA regulated clients that stagger their CASS visits throughout the period under review in a series of interim visits. For those clients where interim visits are scheduled in Q1 2016, those teams need to be sufficiently trained to be compliant with the Standard before the planning of such visits takes place. If the Standard cannot be finalised by 30 September 2015, then its effective date should be deferred to 1 January 2017. Such a lead time is not inconsistent with other standards issued by the FRC and other standard setters.

Q3: Content of the proposed Standard

We agree with the proposed approach to include all reporting requirements in a single standard. We are surprised to see a Standard with bold and non-bold paragraphs, rather than following the format adopted in the ISAs, with a section containing the Requirements and a separate section for the Application Guidance. However, we have a number of comments and observations to make in relation to individual paragraphs and have included these comments in Appendix 2 to this letter.

We note that there is no mention of Mandates (CASS 8) and Collateral (CASS 3) in the Standard despite CASS 8 and CASS 3 being a specific requirement within the CASS assurance report. We recommend that due consideration is given to including requirements and guidance on the appropriate approach in respect of mandates and collateral.

We are also concerned there is a lack of guidance in this Standard in its application to the concepts in CASS 5 relevant to insurance intermediaries. For instance the Standard does not provide guidance to differentiate between a statutory trust regime and a non-statutory trust regime, or refer to the exemptions available to insurance intermediaries, and in places this Standard refers to bold type requirements that are not relevant to insurance intermediaries, such as limited assurance reporting and CMARs. We identify these paragraphs in Appendix 2 to this letter.

Q4: Proportionality of requirements

We understand the challenge of striking the appropriate balance between requirements and guidance. In the proposed Standard there are 111 bold (requirement) paragraphs and 59 non-bold (guidance) paragraphs. By way of comparison, ISAE 3000 (Revised), 'Assurance Engagements Other than Audits or Reviews of Historical Financial Information' contains 83 requirements and 200 paragraphs of guidance, while ISRE 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity', which albeit set out in a different

format, has a ratio of approximately double the number of guidance paragraphs to its requirements.

We believe that the balance currently contemplated in the Standard is skewed too much towards a prescriptive approach, without allowing for the exercising of professional judgement by way of guidance. We strongly agree with paragraph 38 of the Standard which requires the CASS assurance team to exercise their professional judgement in planning and performing the assurance engagement. However, this judgement is then effectively removed from the CASS auditor in areas such as understanding the entity, risk assessment, the provision of training and executing the engagement, by the Standard mandating numerous bold paragraphs in each of these areas. In our experience, the more mandatory the requirements, the more the assignment becomes a checklist exercise and less qualitative judgements are applied. Teams perceive the list to be exhaustive and fail to use their professional judgement to consider the wider matters relevant to their particular entity. In particular, we believe that examples should not be included in requirement paragraphs but be in non-bold (guidance) paragraphs. We identify these paragraphs in Appendix 2 to this letter.

In response to your request for additional areas to include, we believe that this would be in the area of consideration of automated IT systems and controls that underpin the CASS ledgers, interfaces and reports produced by the client. The Standard would benefit from having a specific requirement for the CASS team to consider whether the client's systems relevant to CASS have automated IT controls and if so, to understand the General IT control environment and evaluate such systems, especially as CASS systems are, more often than not, distinct to those that are used in the generation of financial statements.

Q4: Engagement quality control review

We understand the FRC's motivation behind classifying firms that hold client assets as being in the public interest; however, in our view, we do not agree with the assertion that all CASS assurance engagements are in the public interest as such a statement does not take cognisance of materiality and/or risk. We have reservations with the mandating of an EQCR for all reasonable assurance engagements. We believe that professional services firms take a risk-based approach to such engagements, under which EQCRs are appointed for those CASS assurance engagements that are determined to be higher risk by the professional services firm. Accordingly, we believe that paragraphs 141 and 143 (ii) should be amended to reflect this.

We also are concerned there might be some misinterpretation with the term in the Standard '*in the public interest*' with a 'Public Interest Entity'. We would like the Standard to clarify that entities holding client money and/or custody assets are not 'Public Interest Entities'.

Q5: Ethical requirements

We agree with the proposal to require the CASS auditor to comply with the FRC's Ethical Standards, however we question whether this can be applied proportionately. In essence, many FCA regulated entities are small and are akin to closely owned SMEs which do not pose the type of systematic risk to the market posed by larger regulated firms. There is a real concern in relation to the current standards as we consider they might inhibit many of these smaller entities from obtaining the best advice on a timely basis and we question whether that is in the public interest. We would urge the FRC to consider the proportionality of the application of the existing stricter requirements to such entities.

Q6: Requirements relating to training of CASS auditors

We agree with the principle that members of the CASS assurance team need to have undertaken appropriate training that is commensurate with their role on the engagement before performing any work on it. We concur that there are conceptual matters that partners and members of staff

involved on CASS assurance engagements need to understand a priori, such as business models, transaction flows, principles behind segregation and record keeping. However, we are concerned as to how the requirements relating to training are worded in the Standard. Further to our concerns outlined in our response to question 4 on proportionality, we believe that paragraphs which contain examples of matters that could be included in training should be set out in non-bold (guidance) paragraphs. For example, CASS assurance teams that are solely performing limited assurance engagements need training on asset identification and segregation but do not need a detailed understanding of the CASS rules on reconciliations.

Q7: Communication deficiencies in internal control to management and the governing body

We concur with the FRC's approach to include requirements in the Standard relating to the communication of deficiencies in internal CASS controls to management. We believe it would be beneficial if guidance was added to the Standard in this regard, for instance that the CASS assurance team records who they consider to be management and 'those charged with governance' for the purposes of reporting such matters.

Appendix 2: BDO LLP's comments and observations on specific paragraphs

Paragraph 5d

We suggest that point (d) needs additional clarification that this is a pre-authorisation confirmation along similar lines to point (c) that this is in respect of a firm's proposed adoption of a non-statutory client money trust.

Paragraph 10

The definition of limited assurance client asset report makes reference to "*that risk*" when it has not previously explained what risk this is referring to.

The definition of a walk through test makes reference to tracing "*a few*" transactions through the firm's systems, which is not correct, as in most instances tracing one transaction through the system confirms to the CASS auditor whether the system is operating as intended.

The definition of the underlying subject matter, in relation to the limited assurance report, we believe this should read ... the firm's "*non-holding*" of client assets, because in a limited assurance reporting engagement the CASS auditor is confirming that nothing has been held.

Paragraph 11

As outlined in our response to Question 4 in Appendix 1 above, we believe that the examples of understanding listed in this paragraph should be included in a non-bold (guidance) paragraph and not a bold (requirement) paragraph. This is to allow the CASS auditor to exercise their professional judgement in terms of determining what information they need to obtain from the regulated firm in order to plan their work.

Paragraphs 12 and 13

Whilst acknowledging the informational value of asking the client, which the separation of paragraphs 12 and 13 highlight, in practice this is not always workable for small firms, and we recommend these paragraphs are joined into one requirement.

Paragraphs 14 and 16

We believe that the Standard needs to be consistent when referring to client money and custody assets in terms of holding or controlling thereof. Paragraph 14 contains the phrase "*holding or controlling*" but paragraph 16 only includes the phrase "*holding*". In order to minimise misunderstandings, we believe that the Standard should include the term "*or controlling*" after "*holding*", or, if this is intentional, state so and explain why.

Paragraph 15

First sentence, we suggest deleting the words "*the existence of.*"

Final sentence we suggest the Standard should clarify that the obligation on the CASS auditor to report directly to the FCA is not a CASS requirement, but a SUP requirement.

Paragraph 17

The requirement in this paragraph is not correct in its application to insurance intermediaries, which do not require a limited assurance report in these circumstances. This paragraph needs the same caveat as included for paragraph 16.

Paragraph 36

As outlined in our response to Question 4 in Appendix 1 above, we believe that the examples of training listed in this paragraph should be included in a non-bold (guidance) paragraph and not a bold (requirement) paragraph. This is to allow the CASS auditor to exercise their professional judgement in terms of determining training needs.

Also we are concerned that, given how it is currently worded, paragraph 36 may be construed as an exhaustive list of training requirements but we do not believe this to be the FRC's intention. In order to avoid any misunderstanding, the FRC may want to consider the wording of this paragraph.

Paragraph 42

We consider the term "insolvency mindset" is ambiguous and contentious, and we request that guidance is provided to clearly explain the level and depth of knowledge required. For instance at one extreme it could be implied that the requirement is suggesting the CASS team needs to include an insolvency practitioner in every case, and if this is intentional, state so and explain why.

Paragraph 48

The documentation requirements in paragraphs 43-47 are taken from ISA 230 '*Audit documentation*.' Paragraph 48 however, adds a further requirement, the gist of which is covered elsewhere, not least in paragraph 37 of the Standard. We do not support the Standard having requirements over and above the requirements of the ISAs. We suggest that paragraph 48 is deleted.

Paragraph 55

As outlined in our response to Question 4 in Appendix 1, we believe that the examples listed in this paragraph should be included in a non-bold (guidance) paragraph and not a bold (requirement) paragraph. This is to allow the CASS auditor to exercise their professional judgement in terms of determining the matters relevant to the particular client where systems might be susceptible to CASS breaches. Some of the bullet points listed seem rather specific in focus, and one could suggest other factors that CASS teams might wish to discuss including the status of prior year breaches, management operating philosophy and attitude to CASS compliance, resources etc. In our view the Standard should provide examples (in non-bold text) for the CASS team to consider and for the CASS team to apply appropriate professional judgement to determine what is relevant to their particular client, depending on the facts and circumstances, but we do not agree that the Standard should mandate these considerations by including this in bold text.

We also have reservations with mandating a meeting in all cases to discuss a pre-determined list of matters that may or may not be relevant for all entities. We do not believe this demonstrates proportionality. For a stand-alone legal entity with simple systems, non-complex transactions with little change from one year to the next, a well worded background document from the CASS engagement leader together with notes of a client planning meeting might be sufficient in order to direct the CASS team to plan and perform the CASS assurance engagement.

Paragraph 63(b)

We would like the Standard to provide guidance to assist the CASS auditor in their determination of what is "*of material significance*" to the regulator. The definition in Appendix 12 of the Standard, paragraph 8, states that something is likely to be of material significance when it is

likely to require investigation by the FCA, but we question how a CASS auditor is expected to make that determination.

Paragraphs 73 and 74

As outlined in our response to Question 4 in Appendix 1 above, we believe that the examples listed in these paragraphs should be included in a non-bold (guidance) paragraph and not a bold (requirement) paragraph. This is to allow the CASS auditor to exercise their professional judgement in terms of determining the sources they consider appropriate to obtain from a regulated firm.

In addition, insurance intermediaries do not have to a CASS compliance officer and therefore using this term could cause confusion. Insurance intermediaries do have a compliance officer.

Paragraph 75 and 76

Insurance intermediaries are not required to submit CMARs and therefore we believe it is misleading for the Standard to include a bold (requirement) paragraph and a non-bold (guidance) paragraph on CMARs which are not relevant to all entities within the scope of the Standard without an appropriate caveat.

Paragraph 76

The CMAR is one of several sources of evidence available that the CASS auditor has access to but has no responsibility over. In our view the FRC should not be mandating in the Standard that the CASS team must examine this one source of information for accuracy and completeness. As such we believe that this paragraph should be included as a non-bold (guidance) paragraph and not a bold (requirement) paragraph, with the word "shall" replaced with the word "should".

Paragraph 77

As outlined in our response to Question 4 in Appendix 1 above, not all clients have a formal risk assessment and it is not a breach of CASS if they do not. We question whether this first part of the first sentence is indeed necessary to include as a bold (requirement) paragraph, as it is in any event referred to in paragraph 85.

Paragraph 83

We concur with the first sentence in this paragraph that the CASS team should evaluate the control environment. However we do not agree that the remainder of the paragraph - that the CASS team should evaluate the culture of honesty and ethical behaviour of management - should remain a bold text requirement. This has been extracted from ISA 315, '*Identifying and assessing the risk of material misstatement*' which is applicable to the audit of financial statements where there might be incentives and pressures on management to manipulate the results they present in a set of financial statements. In a CASS assurance engagement, with the firm's three lines of defence to identify and correct breaches and have CASS oversight, it is not the evaluation in itself that is important, but how the CASS team responds to the findings that is key. In our view the Standard should require (in bold text) the CASS team to evaluate the control environment, and then provide (in non-bold text) guidance to CASS teams to recognise that the client's culture may have an impact on the CASS risk assessment and to determine their work accordingly.

The CASS auditor is not required to design procedures to look for general matters to report to the regulator. This requirement currently reads as if the FRC is suggesting the CASS auditor must design procedures to report on the fit and proper conduct of management, whereas only if

anything comes to the attention of the CASS auditor that causes concern, then the CASS auditor considers their reporting obligations under ISA 250B.

Paragraph 85 and 86

We believe that this paragraph should be included as a non-bold (guidance) paragraph and not a bold (requirement) paragraph. Not all clients have a formal risk assessment process in place and it is not a breach of CASS if they do not. If the CASS team identifies that the firm has failed to put in place a control for a specific CASS rule then this would be identified as a breach and reported as such. However if the firm does not have a formal risk assessment process, but the hands-on control by management is determined as a sufficient compensating control to mitigate this, then it might not impact the CASS report, nor would it be appropriate to report this as a deficiency in internal controls. Therefore we question why this is included as a requirement.

This is similar to the point we make above regarding paragraph 83, concerning the client's culture. In our view, the Standard should provide (in non-bold text) guidance to CASS teams to recognise that a client's risk assessment is one of the inputs into the CASS auditor's risk assessment and to determine their work accordingly.

Paragraph 87

We concur with the first sentence in this paragraph. However we do not agree with the requirement in the rest of the paragraph for the CASS team to document the considerations extracted from ISA 610 (Revised) June 2013, '*Using the work of internal auditors*' applicable to a financial statements audit. In a CASS assignment, if the firm has an internal audit function, the CASS team is required to read the CASS related internal audit reports to identify CASS breaches reported to the firm by third parties to include in the breaches schedule attached to the CASS assurance report. The CASS auditor's view of the standing of the internal audit function or whether the internal audit function has adopted a disciplined approach is not relevant.

This is similar to the point we make above regarding paragraph 83, concerning the client's culture. In our view, the Standard should require the CASS team to gain an understanding of the compliance and monitoring activities established by the client in order to assess the CASS risks, and to determine an appropriate testing strategy in response to those risks. Then separately in non-bold text, provide guidance to CASS teams as to the various factors they might want to consider that may have an impact on the CASS risk assessment. It is highly unlikely that the CASS auditor can rely on the internal audit function and therefore we consider the bold requirement of paragraph 87 falls away.

Paragraph 91

The phraseology used in this paragraph "*internal and external reconciliations*" are not terms used by insurance intermediaries under CASS 5. In the context of CASS 5 external reconciliations are called bank reconciliations.

Paragraph 93

As outlined in our response to Question 4 in Appendix 1 above, we do not think that this paragraph takes account of proportionality. In reality many small clients do not have the segregation of duties structures that the larger CASS firms can accommodate, but mitigate this by compensating controls such as the hands-on control by management. It is not the segregation per se that is important, it is the operating effectiveness of the controls that management has put in place that is key. Accordingly, we believe that this paragraph should be amended to reflect this.

Paragraph 99

We are not convinced that this paragraph hits the point. We train our staff that when they identify a CASS breach this immediately indicates, prima facie, that a control was not operating effectively. Either the control was not designed appropriately, or the control was not operating effectively. The CASS team needs to investigate the reason why the control failed, the duration and severity of the breach for inclusion in the breaches schedule attached to the CASS assurance report. Accordingly, we believe that this paragraph should be amended to reflect this.

Paragraph 123

In our opinion the second sentence of this paragraph is inconsistent with the quality objective of this Standard. We appreciate it has been carried forward from Bulletin 2011/2 however in our view, the overarching Rules within CASS 6.2 and CASS 7.12 that require firms to have adequate arrangements, organisational arrangements and robust systems, implies that if CASS teams identify inadequate systems then it should, prima facie, be raised as a breach of those rules. Accordingly, we believe that this paragraph should be amended to reflect this.

Paragraph 126

In our view the need for an adverse opinion also arises not only when breaches are identified that are systemic or pervasive, but also where the firm has put client money at risk. That is not to say that client money has actually been lost, but that the control deficiency identified, highlights a sufficient gap in the systems as to put client money at risk. Accordingly, we believe that this paragraph should be amended to reflect this.

Paragraphs 138 and 139

We suggest the words “...that have not been communicated to management by other parties and” are deleted from paragraph 138 as it implies the CASS auditor needs to carry out further procedures to look for evidence of what has been communicated by other parties, and scale back its communications accordingly.

We also think that this section would benefit from additional guidance that the CASS auditor should identify at the planning stage who they consider as ‘management’ and ‘those charged with governance’ for the purpose of reporting deficiencies in internal control that are not CASS breaches.

Paragraph 141

As outlined in our response to Question 4 in Appendix 1 above, we do not agree with the assertion that all CASS assurance engagements are in the public interest and we have reservations with the mandating of an EQCR for all reasonable assurance engagements. Accordingly, we believe that paragraphs 141 and 143 (ii) should be amended to reflect this.

Paragraph 143(b)(ii)

Paragraph 143 (b) (ii) goes further than the requirements of ISA 220, ‘Quality control for an audit of financial statements’ and as a result we do not agree that (ii) should be included in the Standard. We do not support the Standard mandating requirements over and above that of the ISAs. We suggest that paragraph 143 (b)(ii) is deleted from the bold (requirement) paragraph.

Paragraph 146

This paragraph is not applicable to insurance intermediaries, which do not require a limited assurance report in these circumstances. This paragraph needs to include the same caveat as included for paragraph 16.

Paragraph 147

To add clarity, we suggest the words “...unless another firm has been appointed CASS auditor” is added at the end of the paragraph.

Paragraph 158 to160

These paragraphs are not relevant to all entities, for instance insurance intermediaries or fund managers that do not hold or control client money. To require the CASS auditor to ask these questions to the client would demonstrate that the CASS auditor has not understood the business. We believe that this paragraph should be included as a non-bold (guidance) paragraph and not a bold (requirement) paragraph.

Appendix 11

To clarify that this report is a pre-authorisation reporting assignment, we suggest inserting into the illustrative report template, the section that appears in the illustrative report example in Appendix 10, in square brackets, entitled “*Inherent limitation in our engagement...*”