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Dear Mark,

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

Thank you for the opportunity to respond to this consultation. We are grateful for our engagement with you throughout the drafting process. This letter represents the views of PricewaterhouseCoopers LLP, the UK member firm of the PwC network, and is not intended to represent the views of our clients.

We recognise that auditors play a crucial role in achieving the FCA's objectives around the client assets (CASS) regime. We are fully supportive of the overall goals of the Assurance Standard and the efforts of the Financial Reporting Council (FRC) to improve the assurance framework under which the auditor reports.

We have extensive experience as CASS auditor to firms throughout the asset management, banking and insurance broking industries. Based on that experience, we believe that several key areas of the proposed Assurance Standard require further amendment, including:

- **Ensuring a proportionate, risk based approach to the CASS audit.** We recognise that there is no materiality around the *reporting* of CASS rule breaches identified by the auditor or the firm, but we strongly believe that it is appropriate for the auditor to adopt a proportionate and risk-based approach to performing the engagement, as is the case with any other type of assurance framework. As drafted, the Assurance Standard will require the auditor to work to the same level of precision with respect to the CASS audits of a CASS large firm with £trillions of custody assets as it does for audits of insurance brokers holding £30k in client money.
- **Applying clear, consistent requirements for all types of reports.** The level of detail in the required procedures for the auditor varies greatly for the different types of reports that the Assurance Standard applies to. In particular, the Assurance Standard lacks clarity around the requirements for 'Special Reports'. We believe there is a risk that the FCA, regulated firms and their auditors will have different interpretations as to the auditor's role and duties with respect to non-standard processes if this area of the Assurance Standard is not clarified.

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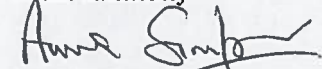
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- **Technical accuracy.** We have noted some drafting and technical matters with respect to the operation of the CASS rules and the rules in the FCA's Supervision Manual (SUP) which should be addressed in the final Assurance Standard which warrant further careful consideration.
- **Clarifying required procedures.** In some areas, the draft Assurance Standard is unclear as to whether procedures to be undertaken by the auditor as part of the CASS audit are mandatory or optional. We believe it is essential to implement a clear and consistent Assurance Standard to achieve the FRC's objective of improving the quality of CASS audits.
- **Applying appropriate independence requirements.** As the CASS auditor is not necessarily the statutory auditor, we do not consider it is necessary to apply FRC-level firmwide independence requirements to the CASS auditor in order to deliver a quality CASS audit.

As drafted, the Assurance Standard places substantial additional requirements on the CASS auditor which will ultimately result in costs to be borne by the industry which we expect will ultimately be borne by customers.

We provide further detail of our views and our responses to your specific questions in the appendix to this letter, which we would be very pleased to discuss with you in detail. If you would like to discuss our comments, please contact Anne Simpson on 020 7804 2093 or [anne.e.simpson@uk.pwc.com](mailto:anne.e.simpson@uk.pwc.com).

Yours faithfully



Anne Simpson  
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## ***Appendix***

### ***1) Will the proposed Standard achieve its objectives?***

As currently proposed, we do not believe that the Assurance Standard will fully meet its objectives. To provide an effective framework to improve audit quality, to support CASS auditors and to underpin the disciplinary process, we believe that the FRC will need to make further amendments to ensure the clarity, consistency and technical accuracy of the Assurance Standard.

Much of the explanatory material from the pre-existing Bulletin on "Providing Assurance on Client Assets to the Financial Services Authority" (the Bulletin) has been removed from the Assurance Standard. This material provided useful context for the auditor, in particular in relation to the procedures that the auditor should perform as part of a reasonable assurance CASS audit engagement. Removing this explanatory material may be detrimental to CASS audit quality. That being said, the contextual material includes some paragraphs which are very similar to those in the body of the Standard (viz para 55 contextual material cf para 36 of the Standard). It is not entirely clear what the separate purpose of the contextual material is, and some of it is out of date and refers to old rules.

Some specific measures in the draft Assurance Standard, such as requiring an engagement quality control reviewer who is independent of the audit team, could be detrimental to CASS audit quality if implemented as proposed; we set out our further observations on this matter at point 5 below.

Furthermore the references in the draft Assurance Standard to "other applicable rules" (paragraph 10), internal audit and compliance effectiveness (paragraph 87), evaluation of firm's management culture (paragraph 83) and reporting on the CMAR or equivalent (paragraph 15) may increase the expectation gap between firms, the FCA and the auditor over the scope of the CASS audit given that the audit reporting requirement in SUP 3.10.5 R does not require the auditor to report on those areas (i.e. the auditor is not required to report on rules outside of CASS, internal audit effectiveness, the firm's management culture, the three lines of defence or other governance arrangements, the firm's CMAR reports, etc.).

We have separately provided you with feedback around some technical matters we have noted and would be very happy to discuss these with you further.

### ***2) Effective date***

The FRC has proposed that the Assurance Standard be mandatory for periods beginning after 1 January 2016. We believe that period will not allow auditors sufficient time to implement the new Assurance Standard in its final form, and to train their staff on the new Assurance Standard. Without a sufficient transitional period, audit firms will find it difficult to meet the requirements of the Assurance Standard, to develop appropriate audit and risk management procedures and to identify and train staff to deliver the necessary work.

Given that the new Assurance Standard will require audit firms to make changes to their audit programmes, procedures, and training, we believe that the Assurance Standard should not be mandatory until 30 June 2016 at the earliest.

### ***3) Content of proposed Standard***

We agree with the proposal to include all material relating to CASS assurance reports in one Standard. We believe this will reduce the potential for confusion, contradiction between different standards applying to different CASS assurance reports, divergence in requirements or misinterpretation.

However, we note that the draft Assurance Standard is silent on certain key areas. For example, the term 'client assets' is used throughout the Assurance Standard. Paragraph 10 defines 'client assets' as being a generic term covering client money and assets: as a result, there appear to be no requirements or guidance for the auditor relating to the audit of mandates or collateral. In our view, it is particularly



important for the Assurance Standard to explicitly cover these areas given that SUP 3.10.5 R does not provide a framework for the auditor around management's "claim" to have mandates or collateral.

We also note that the requirements for 'Special Reports' are very limited. As the underlying FCA rules are silent on the detailed framework for the auditor's 'reasonable assurance' Special Reports, it is critical that the FRC provides sufficient guidance in the Assurance Standard to ensure a level playing field for auditors and a shared understanding between the FCA, CASS auditors and firms with respect to the form, content and underlying procedures for these reports.

There is a lack of guidance for the auditor about the meaning of 'limited assurance'. The draft Assurance Standard defines it broadly being a level of assurance below that which is necessary for reasonable assurance. The lack of sufficient clarity as to the meaning of limited assurance will make such engagements highly risky for the auditor, who may be held to account for failure to detect any extant client assets even where such assets are immaterial in the context of the regulated firm's business. Yet there are a large number of mandatory requirements which could result in the CASS auditor needing to carry out more onerous procedures for some limited assurance engagements than for some reasonable assurance engagements.

The draft Assurance Standard sets out a large number of specific mandatory procedures with respect to limited assurance opinions, but does not provide concrete requirements around the testing to be performed for reasonable assurance opinions. Other assurance frameworks based on ISAE 3000, for example AAF 01/06, provide much more granular detail around reasonable assurance procedures including descriptions of procedures to understand the business, the types of tests to be performed and sample sizes.

The draft Assurance Standard does not address 'mixed' opinions, which an auditor gives in circumstances where a firm holds client assets for part of the year but claims not to hold client assets for the rest of the year. Paragraph 28 of the draft Assurance Standard states that the form and content of the auditor's report must not be varied from that in SUP 3 annex 1 R. For 'mixed' opinions, this presents conceptual difficulties for the auditor in determining the scope and nature of the report. We believe this issue should be addressed in the Assurance Standard.

The draft Assurance Standard does not address whether or not the CASS auditor needs to obtain comfort over ITGCs or how it should use controls reports (other than a brief reference to change controls in paragraph 93). We believe that the Assurance Standard has been drafted with an implicit read across to ISAs, which is inappropriate in the context of a direct reporting engagement.

The draft Assurance Standard places requirements on the auditor which go beyond the FCA's requirements for audit reports set out in SUP. In particular, paragraph 15 requires the auditor to report on whether or not the regulated firm has reported all client assets to the FCA. The mechanism by which firms report client assets to the FCA is the CMAR (or annual declaration for CASS small firms) which falls outside the scope of the CASS audit as defined in SUP 3.10.4 R. The drafting could be read to imply that the firm's management has made an assertion regarding the accuracy of its reporting to the CASS auditor, which is not the case. The CASS audit is a direct reporting engagement where the auditor does not report against an assertion made by management.

Finally the draft Assurance Standard does not sufficiently identify those requirements applying to insurance intermediaries in several respects: (i) it does not make it sufficiently clear that insurance intermediaries do not require a limited assurance opinion, (ii) that reasonable assurance opinions for insurance intermediary do not cover custody assets and (iii) that auditors are not required to send their opinions to the FCA. The draft Assurance Standard also does not draw out any differences relating to Debt Management firms.

#### **4) Proportionality of requirements**

We believe that proportionality will be key to the success of the Assurance Standard in achieving the FRC's objectives without being unduly burdensome or costly. Ultimately the costs of the CASS audit will be borne by the customers of the regulated firms and as such we do not consider that it is in the public interest to impose expensive and burdensome audit requirements across the board. We believe that the FRC should have greater regard to the principle of proportionality. For example, the proposed Assurance Standard imposes a requirement for engagement quality control review (EQCR) which will

apply to all insurance intermediary CASS audits despite the very small size of many of these engagements. We suggest that the FRC should have greater regard to the principle of proportionality. This would be consistent with the approach taken by the FCA which applies different requirements to firms according to the value of client assets held (e.g. under the CF10a/senior manager regime, CMAR and other reporting requirements, frequency of CASS supervisory visits, etc.).

We note that much of the draft Assurance Standard is in bold text and therefore is a requirement. We consider that a number of paragraphs in the draft Assurance Standard would be more appropriate as guidance to be applied proportionately. For example, the auditor is required by paragraph 94 to conduct walkthrough tests, with a walkthrough being defined as "tracing a few transactions through the firm's systems". In our experience it is not normal to require more than a single representative transaction to be traced as part of a walkthrough. To give a second example, paragraph 55 requires the CASS engagement leader to meet with the engagement team on all engagements to discuss basic information such as the firm's business model and any arrangements with third party administrators. We believe that auditors should decide on a case by case basis whether such meetings are necessary based on the complexity of the firm and its arrangements for handling client assets, whether the firm's business model or circumstances had changed during the year, etc. For example, a formal meeting might not be necessary for a non-complex firm on which the auditor was providing a limited assurance opinion in a year of no change.

The draft Assurance Standard places more onerous requirements on the CASS auditor where they are also the statutory auditor (paragraph 153). We do not believe that is appropriate. We also consider that the model of engagement risk set out in paragraph 78 *et seq* and the guidance in paragraph 102 are too widely drafted. Paragraph 77 initially identifies engagement risk as the risk of giving an unqualified opinion when breaches had occurred, but paragraph 78 *et seq* appear to be based on auditors not fully identifying all breaches which have occurred during the year. Paragraph 103 suggests that the auditor's testing should cover all applicable systems at all times, which is not an accurate description of the sample testing that auditors perform.

In our experience unqualified opinions are rare. Nonetheless the FCA and FRC regularly challenge auditors over failure to identify a specific breach even where the overall CASS audit report was qualified. In order to both support CASS auditors and to provide an effective disciplinary framework, the Assurance Standard will need to adequately identify (i) whether the CASS auditor is required to design procedures that mitigate the risk of giving an inappropriate opinion (i.e. clean, except for or adverse) or (ii) whether the auditor's procedures should mitigate the risk of failing to report a specific breach that has occurred. Given the complexity and volume of investment business transactions, we do not consider it to be reasonable, proportionate or commensurate with a reasonable assurance report to require the auditor to design procedures to mitigate the risk of failing to detect every instance of non-compliance with an applicable rule and we ask that the FRC clarify the draft Assurance Standard in this respect.

The guidance on adverse opinions in paragraph 126 *et seq* is largely taken from Bulletin 2011/2, which is out of date in a number of respects. It should be updated to reflect the FCA's and FRC's current expectations.

We would also recommend the FRC carries out a cost benefit analysis with respect to the impact of the Assurance Standard on CASS audit costs.

## **5) Engagement Quality Control Review**

We note that the EQCR requirements in the draft Assurance Standard go some way in excess of ISAE 3000. Paragraph 143 of the draft Assurance Standard mirrors the core requirements of ISAE 3000 para 36, being:

*"For those engagements, if any, for which a quality control review is required by law or regulation or for which the firm has determined that an engagement quality control review is required:*

- a. *The engagement partner shall take responsibility for discussing significant matters arising during the engagement with the engagement quality control reviewer, and not date the assurance report until completion of that review; and*
- b. *The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the assurance report. This evaluation shall involve: (Ref: Para. A75)*
  - i. *Discussion of significant matters with the engagement partner;*
  - ii. *Review of the subject matter information and the proposed assurance report;*
  - iii. *Review of selected engagement documentation relating to the significant judgments the engagement team made and the conclusions it reached; and*
  - iv. *Evaluation of the conclusions reached in formulating the assurance report and consideration of whether the proposed assurance report is appropriate."*

We consider that only a CASS subject matter expert (SME) would be able to effectively carry out the EQCR role described in the draft Standard. In our experience CASS audit quality is best achieved by embedding CASS SMEs within the engagement team, so that they understand the business, observe and participate in walkthroughs and review documentation from the firm such as acknowledgement letters, custody agreements, reconciliations and client terms and conditions. In order to maintain audit quality, we consider that after the Assurance Standard is implemented, on many engagements auditors will need to both embed a CASS SME within the engagement team and to have an EQCR carried out by an independent SME. There are limited numbers of appropriately experienced staff throughout the industry who are sufficiently expert in CASS to carry out these roles. We consider that, as drafted, the EQCR requirements are an onerous commitment which will result in significant resource and training costs for audit firms. It may also reduce competition in the audit market as smaller firms may not be able to attract, train and retain sufficient numbers of CASS SMEs to cover both roles.

However, paragraphs 141-145 include onerous requirements which are supplemental to those in ISAE 3000 and ISQC 1. In particular, we consider that the presumption that all reasonable assurance CASS engagements are of public interest and therefore require EQCR to be unrealistic and disproportionate. As the draft Assurance Standard requires the reviewer to be separate from the audit team, the role envisaged by the FRC could increase CASS audit costs without a concomitant increase in CASS audit quality. We believe that an independent EQCR should be carried out on engagements where the engagement risk is high, and the Assurance Standard should allow audit teams to assess on a case by case basis whether the EQCR role is necessary and/or beneficial: wider non-audit standards including ISQC 1 and auditing standards allow the auditor to take a proportionate approach to identifying which engagements should be in scope of EQCR. At the very least, we believe this presumption should be rebuttable and that paragraphs 141 and 143 of the draft Assurance Standard should have the status of guidance.

## **6) Ethical requirements**

We disagree that the CASS auditor should have to comply with the FRC Ethical Standards for Auditors as paragraph 17(c) may effectively apply firm-wide independence requirements, particularly at partner level, to what may be a non-audit assurance engagement for a non-audit client. Requiring firm-wide independence may be anticompetitive and restrict regulated firms' ability to appoint a CASS auditor which is not the statutory auditor. It also would set an unwelcome precedent for other non-audit assurance standards. The CASS Assurance Standard is largely based on ISAE 3000 which requires IESBA (IFAC) independence. The IESBA code is incorporated into the ICAEW code of ethics to which we state our compliance in any ISAE 3000 assurance report.

The CASS report may be provided by either the statutory auditor or any other competent firm. We consider that mandating the FRC level of independence would be gold plating whenever the CASS auditor is not the statutory auditor: we believe that the IESBA code provides appropriate protection

around independence for non-audit assurance. We believe that the CASS auditor should have regard to independence at a principles level by considering the threats to independence and the safeguards in place, but not with the level of detail that the statutory auditor must have regard to. We note that FRC-level independence is not required elsewhere in non-audit assurance standards.

#### ***7) Requirements relating to training of CASS auditors***

We acknowledge the importance of training CASS auditors and we recognise that CASS audit quality is dependent on audit firms having staff with sufficient expertise and that this expertise comes in part from training. Nevertheless, training can potentially be delivered in many ways including on-the-job experience. The draft Assurance Standard is unclear as to whether or not such experience is considered to be 'training'. We note that paragraph 36 on training is in bold text and therefore all elements are mandatory: we consider that these extensive requirements may be excessively onerous, particularly in the context of limited assurance engagements.

We believe that the Assurance Standard should explicitly acknowledge that the extent and nature of training required to carry out limited assurance CASS engagements is different from that required in reasonable assurance engagements. As an example, we do not believe that the audit team carrying out a limited assurance engagement should be required to have experience or training concerning the practical problems associated with the performance and review of client asset reconciliations.

#### ***8) Management letter***

We agree that, in most instances, it is appropriate for the auditor to report to those charged with governance in addition to providing them with a copy of the CASS report. We consider that the FRC could usefully provide further guidance on the expected content of management letters. For example, given that the 'applicable criteria' for the CASS auditor's report is the Rules as denoted by the suffix R, does the FRC intend that where a firm has failed to follow guidance in the FCA's CASS manual, should auditors report this only in the management letter, rather than the schedule of breaches appended to the CASS auditor's report?

#### ***Other technical issues***

We have noted a number of technical issues and drafting inconsistencies in the Assurance Standard and as working party members we will provide further detail on this to you privately. We have particular concerns in relation to paragraphs 58 – 66 on the auditor's right and duty to report. It appears that this text is largely duplicative of ISA 250B and the relevant practice notes, without either having been updated to acknowledge the auditor's duty to report to the PRA as well as the FCA or that the CASS auditor's duty to report extends to any breach of any regulatory requirement and not solely breaches of CASS. We also note that under FSMA the auditor is not required to carry out additional work to identify reportable matters. Instead, the CASS auditor has the right and duty to report *if* they come across such matters in the normal course of the CASS audit. We suggest that this section should be redrafted as standalone guidance that is distinct from ISA 250B and the relevant practice notes and which takes into account the specifics of the CASS auditor's role and the FCA's heightened sensitivity to potential CASS breaches.

