

Association of Accounting Technicians response to the FRC consultation on: Providing Assurance on Client Assets to the Financial Conduct Authority

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the Financial Reporting Council (FRC) consultation on “Providing Assurance on Client Assets to the Financial Conduct Authority (FCA)” (condoc) released on 14 May 2015.
- 1.2. AAT is submitting this response on behalf of our membership and from the wider public benefit perspective of achieving sound and effective administration in the field of audit and accountancy.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined. Furthermore, our comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by our operationally skilled members in practice.

2. Executive summary

- 2.1. This Assurance Standard has been developed to support and challenge auditors when reporting on compliance, by regulated firms, with the Financial Conduct Authority’s (FCA) Client Asset (CASS) rules, which are designed to ensure the effective safekeeping of client assets and client monies. More than 1,500 firms hold more than £100 billion of client assets and £11 trillion of other custody assets (page 1, condoc).
- 2.2. AAT supports the proposal to issue a single Standard in respect of “Providing Assurance on Client Assets to the Financial Conduct Authority” (Q3, page 5, condoc), particularly to emphasise to those providing the assurance, the objectives of the assurance review and the need for a specific tailor-made approach to such assignments as compared to the approach to statutory audits (3.7, below).
- 2.3. The most important topic which has to be addressed by the Standard is the mind-set required to undertake a Client Assets Sourcebook audit (3.5, below).
- 2.4. The CASS auditor’s mind-set should be to not only consider the adequacy of systems in place but to consider and test the facility for unauthorised interventions into the system which could place the security of clients’ assets at risk, whether accidentally or intentionally (4.2, below).

3. AAT has provided responses to the eight questions set out in the FRC consultation on “Providing Assurance on Client Assets to the Financial Conduct Authority”

Question 1

Will the proposed Standard achieve its Objectives?

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?

- 3.1. It is AAT's view that the objectives set out in paragraph 19 of the introduction (page 3, condoc) and the quality of client asset assurance engagements will be achieved by the introduction of the new Standard. However, there is a need to provide guidance on the potential impact of "materiality" in the context of the safe custody of clients' assets as being totally different to its impact on a statutory audit, which looks at a "true and fair view".
- 3.2. While it is understood that past deficiencies in CASS audit reports¹ is one of the issues giving rise to the perceived need for a Standard, the draft Standard includes a number of examples of standard wordings for CASS audit reports and AAT considers that the deployment of examples can be helpful to illustrate the requirements of the FCA, there is a risk that audit firms will see the examples as "model" reports and adopt the format closest to the circumstances of the assignment. AAT considers that it needs to be clarified that CASS audit reports primarily need to identify to the FCA where problems with the safe custody of client assets could arise.
- 3.3. It is also well understood that the past deficiencies in CASS audit reports² became apparent as a consequence of solvency problems suffered by many financial institutions during the recent recession (page 13, condoc). Consequently, it is considered vital that the CASS auditors must consider the solvency position of the firm being reviewed and be required to report formally if there is any exposure to the risk of insolvency.
- 3.4. While it is appropriate for CASS audit procedures to require that written representations are obtained from the firm's management to remind them of their responsibilities, the CASS auditors should not be permitted to place any reliance on those representations without supporting evidence, otherwise the procedure becomes one of "self-certification" and defeats the object of the process.

Question 2

Effective Date

The proposed Standard is effective for reports to the FCA with respect to client assets covering periods commencing on or after 1st 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 1st January 2016?

- 3.5. From a practical viewpoint, the compulsory introduction of the proposed Standard for periods commencing earlier than 1st January 2016, while achievable, could place undue pressure on CASS audit firms as a result of the need to amend systems and procedures, to train staff (particularly as regards the change of mind-set referred to in the proposed Standard) and to ensure that engagement leaders and others with responsibility for CASS audits are fully aware of the requirements of the new Standard, with a resulting risk that the objectives of the new Standard will not be achieved initially and may actually see a temporary decline in the quality of CASS audits.
- 3.6. Taking into account the commentary in 3.5 (above) it is AAT's view that it would not be appropriate to mandate the application of the Standard for reporting periods commencing before 1 January 2016 in order to achieve the objectives set out in paragraph 19.

¹ Para 1.10 of [CP10/20](#), Financial Services Authority, Improving the auditor's report on client assets

² Para 1.10 of [CP10/20](#), Financial Services Authority, Improving the auditor's report on client assets

Question 3

Content of proposed Standard

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?

- 3.7. AAT fully supports the concept that all of the requirements should be included in a single document so as to provide a complete standalone source of reference.

Question 4(A)

Proportionality of requirements

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.

- 3.8. It is considered helpful and beneficial for the Standard to indicate to CASS auditors those matters which are mandatory and those which provide guidance so as to focus the attention of the CASS auditor on the evaluation of controls over assets (rather than balance sheet verifications).

Question 4(B)

Engagement Quality Control Review

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 judgements 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?

- 3.9. AAT has some concern that if the CASS engagement leader is subject to engagement quality control review throughout the course of the engagement this could result in an "overkill" by the auditor being audited, giving rise to unnecessary costs, particularly as the engagement leader's main responsibility must be to control, direct and review the work of audit staff employed directly on the engagement. Clearly the audit firm should have an internal quality review process in place as regards its procedures for carrying out such assignments, but to have a review process on each individual CASS audit would result in a duplication of the engagement leader's work.

Question 5

Ethical requirements

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.

- 3.10. It is considered essential that CASS auditors should comply with the FRC Ethical Standards for Auditors as regards integrity, objectivity and independence because the FRC will be looking to rely on the professional judgement of the auditors in assessing the potential risks of misstatements to a greater extent than that needed for professional judgement to be applied within the context of statutory audits.

Question 6

Requirements relating to training of CASS auditors

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?

- 3.11. It is reasonable for the Standard to include the requirement for audit staff to be trained to possess the technical knowledge in respect of the FCA's requirements for CASS audit assignments. However, such knowledge in itself, will not achieve the mind-set requirement for the approach to such assignments. This attitude of mind must be dependent upon the supervision and direction imposed by the engagement leader in ensuring a thorough briefing and continuous review throughout the assignment.

Question 7

Communicating deficiencies in internal control to management and the governing body

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 paragraph 137 to 140 of the proposed Standard. Do you agree with the FRC's approach? If not, why not?

- 3.12. On the basis that the nature of a CASS audit is akin to a "systems" audit to identify potentially material risk areas rather than the verification of the true and fair view of financial statements, it must be desirable for all risks, whether potentially material or immaterial, identified by the CASS audit process to be brought to the attention of the entity's management at the earliest opportunity and to be reported to the entity's governing body to enable appropriate action to be taken by the entity.
- 3.13. The reports given by CASS auditors need to be useful and practical. They should not be either vague or too restrictive in the opinions given on potential risk. It is of no benefit to the FCA for the auditor to give a "highly qualified" report by way of self-protection or on the other hand to give a non-informative report on the basis of no consequences of any weaknesses having been discovered in the course of the audit.

4. Other Matters

- 4.1. In addition to the issues raised by the foregoing seven questions, AAT would wish to highlight concerns arising from other matters of relevance to CASS audits and which we believe should be taken into consideration as part of the current consultation activity
- 4.2. The most important topic which has to be addressed by the Standard is the mind-set required to undertake a CASS audit. The CASS auditor's mind-set should not only be to consider the adequacy of systems in place but to consider and test the facility for unauthorised interventions into the system which could place the security of clients' assets at risk, whether accidentally or intentionally. For example, this concept is not adequately tested by a straightforward walk through test of selected transactions, but requires the system to be challenged by the auditor at each step of the walk through test and to carry out extended tests on the critical control points in the system. Consequently a higher level of professional scepticism is required than that applied in a statutory audit assignment.
- 4.3. AAT is not comfortable with the use of the terms "audit" and "auditors" in the context of CASS assignments. While the terms will be fully understood by the FCA and those with a professional background and therefore as such it does not imply a "true and fair view" is being certified, the concept may be misunderstood by others. Although there are limited risks of any serious consequences arising from a misunderstanding of these terms, any possible conflict with the usual meaning applied to financial statements could be averted by referring to these assignments being identified as "Assurance Reviews". One of the consequential effects of the objectives being sought must be to maintain public confidence in the safeguarding of clients' assets by financial institutions and that confidence could be difficult to maintain if it is necessary to explain that the term "audit" does not mean what the public expect its meaning to be.
- 4.4. For the sake of completeness of the proposed Standard, there is a need to include a definition of the qualifications required for a firm to be appointed a CASS auditor. While the proposed Standard states that the entity's statutory auditor does not have to be appointed as the CASS auditor, there is an implied presumption that the firm appointed as such will be authorised to carry out statutory audits. Therefore, AAT would recommend adding a definition for the eligibility for being a CASS auditor.
- 4.5. While it must be vital for firms authorised to carry out CASS audits to be bound by a professional ethical code and subject to a disciplinary process from a recognised professional body, AAT would suggest that for suitably regulated firms other statutory auditors be eligible to be appointed to carry out CASS audits, particularly for smaller reporting entities, on the grounds of costs, accessibility and the mind-set required being totally different to that required for a statutory audit.
- 4.6. AAT is conscious that among the bodies for which the FCA is responsible, there are a multitude of smaller entities active in the financial sector, who handle clients' assets (such as independent financial advisers and brokers) who need to be subject to CASS audit but do not warrant the costs of such being carried out by any of the major audit firms. Certain of the AAT's own members in practice already have any involvement in similar assignments related to Air Travel Organisers' Licensing (ATOL) and Civil Aviation Authority (CAA) requirements and could be well placed to provide CASS audit services to smaller entities.

5. Conclusions

- 5.1. AAT considers the most important factor to be addressed in relation to CASS audits is the matter of the change of mind set required to carry out such a review compared to a statutory audit(3.1, above).
- 5.2. Other critical issues are considered to relate to the confusion caused by the use of the terms “audit” and “auditor”, and the identification of those who should be authorised to carry out assurance reviews (4.3, 4.4, 4.5 and 4.6, above).
- 5.3. As observed in section 4 (above), in addition to addressing questions posed in the condoc AAT has highlighted areas of concerns arising from other matters of relevance to CASS audits and which it was thought should be taken into consideration as part of this particular consultation exercise.

6. About AAT

- 6.1. AAT is a professional accountancy body with over 49,300 full and fellow members³ and 76,400 student and affiliate members worldwide. Of the full and fellow members, there are over 4,100 members in practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 6.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

7. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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³ Figures correct as at 30 June 2015