Financial Reporting Council

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Providing Assurance on Client Assets to the Financial Conduct Authority

Consultation on a new Assurance Standard

response from

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Royal Charter
the Institute of Chartered Accountants in England & Wales

Royal Charter of the 11th May 1880

Victoria by the Grace of God

of the United Kingdom of Great Britain and Ireland Queen Defender of the Faith

TO ALL TO WHOM THESE PRESENTS SHALL COME GREETING!

That the Profession of Public Accountants in England and Wales is a numerous one and their functions are of great and increasing importance in respect of their employment in the capacities of Liquidators acting in the winding-up of companies and of Receivers under decrees and of Trustees in bankruptcies or arrangements with creditors and in various positions of trust under Courts of Justice as also in the auditing of the accounts of public companies and of partnerships and otherwise.

Background

1. The United Kingdom has a large number of financial services firms that may hold client money or custody assets (referred to collectively in this Consultation Document as "Client Assets") belonging to their clients. Client Assets are held by, among others, Investment Businesses, Insurance Intermediaries and Debt Management Companies. The magnitude of client asset holdings is very high, with 1,500 investment businesses holding in excess of £100 billion of client money and £11 trillion of custody assets.

Nature of the entity subject to statutory audit

- A statutory audit of an entity is exactly the same for all entities. A statutory audit (or any assurance report) is the same regardless of what the entity calls itself: a "firm"; a company; a partnership; a statutory body; a protected cell vehicle; a local authority or central government function; a members' organisation; a charity or association; the courts; or any other construct which may be handling, safeguarding or processing that which it does not own. A statutory audit of those who may hold that which does not belong to them, including accrued third party rights where the third party is not a customer, must be identical, irrespective of the form of construct or entity. "*Whose is it?"* is the key question for an audit.

Identity of owner and risk are relevant not "size"

- There is no concept of "large" or "small" in regard the performance of a statutory audit (or other assurance report). There is no universal measure of "large" or "small". For example HBOS before being rolled into Lloyds could by some be considered "large". "Large" could refer to volume of turnover or size of black-hole, i.e. unquantified and unquantifiable. "Large" in such context can uncontroversially only refer to the size of bail-out and short term Bank of England lending, including that which was not fully revealed in its funding prospectus.

Vocabulary

- It is a very dangerous route on which the FRC is embarking, to create new vocabulary which is fundamentally meaningless but which is used to create what are in essence exceptions to basic principles of assurance reporting (direct reporting or otherwise). This is by substituting other methodology which operates to displace the basics of direct reporting.

Forms of assurance reporting: direct reporting cannot be replaced

- In particular substituting assurance reporting for direct reporting is not acceptable, nor is reporting to a third party, whoever they are, rather than the directors, being those charged with the governance of the enterprise severally who must create, maintain and report on proper accounting records and accounts, subject to independent direct reporting (audit).

- An example of such an approach is the certification to the SRA on Client Monies Accounts of those operating as SRA licensed. ICAEW technical has confirmed that members replace the normal audit of client monies with the requirements of this assurance report rather than adding it as an extra activity to the "normal" audit of Client Monies.

Client Monies excluded from 100% substantive testing

- As a result Client Monies are outside the statutory audit. This is wholly unacceptable with devastating effect on the validity and credibility of assurance reporting.
- A proper audit of Client Monies requires 100% substantive testing. In each case the counterparty is different. A full investigation is mandatory where Client Monies are booked to Office Account and/or not cleared within the expected period for the transaction in point. Until the FRC comes down like a ton of bricks on the audit of operations handling Client Monies, such as those which have a simple business model, including those running partnership accounts (possibly outside statutory reporting), it does not have a generic baseline from which to create specialist variations to existing standards. This would prove that such audits are merely variations on a theme.

Vault and safe-custody services

- **Secondly**, the most basic type of holding Client Assets is (a) the provision of vault services; and (b) safe-custody services. A complication arises where delivery of these services is outsourced and the ultimate customer does not know. The distinction between these services and operating as a licensed deposit-taker, is that in the latter case, that which is deposited is fungible, becomes that of the bank, and the depositor receives an IOU. It is a risk to the bank if depositors simultaneously decide to cash in on their IOUs *("run on the bank").*

Change of control

- A further complication arises where there is a change of control and the consequences are not fully notified to the customer, if notified at all either before or after. There is no mandatory reporting of the heads of agreement; contract; other terms to the Prudential Regulatory Authority and, more worryingly, no public notice advertising these agreements, equivalent to the announcement of the bans of marriage. Customers can be rail-roaded into signing new agreement without knowledge of the full and true picture.

- The complexity is increased due to an approach that *"we do not want to interfere in commercial decisions"*. Accordingly it is possible for those involved in such transactions to represent that there will be no change as far as customers are concerned. Months later those same people concerned *"change their minds".* Consumer protection regulations from unfair traders wholly fail the public in such circumstances. Front line prosecutors, such as Trading Standards, must prosecute but do not. Contingent liabilities accrue but are not evaluated.

- The statutory auditor is responsible for getting to the bottom of such arrangements/transactions, ensuring that sufficient notification has been made and that the risks associated with contraventions or defaults; contingent liabilities and claims; or even "mere" shortcomings have been evaluated and quantified. The auditor must report adversely if not. He loses independence otherwise and must resign citing loss of independence.

Holder of client owned (contingent) assets

• **Thirdly** there is no restriction on who holds "Client Assets". Indeed if one buys a sofa and pays for it, then before it is delivered it is a "Client Asset". All risks must be evaluated accordingly. The example as a benchmark is a warehouse or central depot holding customer goods. With financial (contingent) assets, the basic principle of safeguarding what belongs to others applies in the same way as with tangibles. Accordingly the same treatment applies.

Personal data handling – processor or controller?

• The main financial asset which is a Client Asset is personal data, such as bank account details. Banks currently do money laundering checks on a person opening an account and security checks where a ticking box is placed in a branch (can contain a bomb). They do no checks where a third party comes with what they say are "court orders" with a view to stealing the estates of their customers. They willingly freeze customer accounts and groom them for payment of bribes and laundering the proceeds of crime: the customer is not told.

Third party and counterparty (contingent) assets

• **Fourthly** organisations do not just hold customer assets they also effectively "hold" counterparty assets, meaning they control them. This control has not been properly examined. It manifests itself where loans are granted which require a business account to be opened. It applies also where there is an off balance sheet vehicle controlled by a bank or insurer or group funding facilities. The nature of the relationship requires detailed end-to-end understanding and transparent reporting. As the FRC does not compel reporting on counterparties or the requirement to reveal the identity of contingent creditors, the risks to the public are not capable of being understood by the reader of the accounts. This needs urgent rectification. The FRC has stone-walled including by turning to the vested interests rather than the victims for advice on what is required for transparency and risk evaluation.

> *2. The Financial Conduct Authority (FCA) regulates many different categories of firms, including banks, investment banks, asset managers, insurance brokers and financial advisers. Some firms within these different categories may hold client money and assets for long or short periods for a variety of legitimate reasons. A client is at risk with respect to any client asset held by a firm on its behalf where the firm has not made adequate arrangements to separate, in a legally effective way, the clients' assets from its own. Even if the holding period is short the client could lose its assets if the firm has not ensured that the assets are protected (i.e. effectively segregated from the firm's assets) in the event of the firm's insolvency.*

• There is no such body as a "regulator". Self-reporting does not lend itself to oversight. The FSA has had involvement with compliance but excludes cross border arbitrage, "regulatory" arbitrage and operations using off balance sheet vehicles and facades outside the reporting and tax net. It is unclear what it is any more beyond an expensive payroll that hires the private sector and vested interests to do its work, largely undefined.

3. Arising from the nature of insolvency law, client asset protection needs to be structured in the context of the legal entities that hold client assets rather than in the context of the businesses within which the legal entity operates.

- This paragraph is not coherent. The Act is the 1914 Bankruptcy Act. If what is meant is that when A holds asset XYZ which belongs to B, would B be at risk if A goes down? The answer is "no" because that which is in safe-custody or vaults does not belong to the entity providing the service which is the one that it is presumed has folded.
- If what is meant is that money is fungible, so making a deposit with the current High Street banks is risky, that is well known and will not be repaired by a standard. Mixing of client monies is a crime. The authorities imposed a massive fine on JP Morgan and the FRC paid a barrister to let PwC off with a trivial fine no-one would notice.
- The FRC needs to decide whether it is out to protect the public from those purporting to be independent statutory auditors or to make it impossible for their victims to hold them to account and to enforce against them. It cannot do both.

4. Almost all entities (referred to collectively in this Consultation Document as "firms") that hold client assets are regulated by the FCA. The FCA's tenth Principle for Businesses is that "a firm must arrange adequate protection for clients' assets when it is responsible for them". Rules in respect of the tenth principle are set out in the FCA's Client Assets Sourcebook (CASS rules) which require firms to hold client money and custody assets separately from their own in order to minimise the risk of loss to clients in the event of the firm's insolvency. Such losses may arise, for example, from the claims of its general creditors and from right of set-off by institutions which hold the custody assets or client money.

- This is not true especially in a global world. The "principles for business" are very damaging as no one pays any attention to them; FOS staff have never heard of them; and FOS's internal and external auditors have not enlightened them. FOS has been de-railed by CRM vendors. Its presence, giving hope to victims, which never materializes, is devastating.

5. The Financial Services and Markets Act 2000 (FSMA 2000) together with other legislation such as the Companies Act 2006 provide the statutory framework for the obligations of firms and auditors. FSMA 2000 permits the FCA to have rules requiring a firm to appoint an auditor and to impose "other duties" on the auditor of the firm. The duty of an auditor to prepare and submit a Client Assets Report to the FCA is such an "other duty".

- This is not true. FSMA 2000 is about confidence in markets, insider dealing and market abuse (knowing and reckless conduct). Those in possession of price sensitive information are key. In regard the Companies Act it is the officers and shadow directors severally who are key. In respect of the auditor, it is about independence. FSMA 2000 requires a statutory auditor to review that capital adequacy verification is carried out. Those purporting to be auditors watch a process ("review") but do not look at the content. Officers carry the exposure on omissions.

6. The FCA's Supervision Manual (SUP rules) may require the auditor to prepare a Reasonable Assurance Client Assets Report or a Limited Assurance Client Assets Report. Although such engagements are assurance, rather than audit, engagements the generally accepted expression "CASS auditor" is used in this Consultation Document to describe the person who is responsible for preparing and submitting a Client Assets Report to the FCA. A firm need not appoint its statutory auditor to be its CASS auditor.

7. Skilled Person's Reviews under S166 and S166A of FSMA 2000 are outside the scope of the proposed Standard.

- These reviews cannot be excluded. Where a person is hired by the FCA/PRA in such a function the relevant employer cannot continue as statutory auditor. "*Skilled persons"* cannot come from "*auditors".* The auditor is no longer independent and cannot report.

Reasonable assurance client assets reports

8. Where a firm holds client assets the SUP rules require the CASS auditor, annually, to provide a Reasonable Assurance Client Assets Report and in Part 1 of such a report to provide its opinions as to whether the firm, among other things:

a. Has maintained systems adequate to enable it to comply with the applicable FCA client money rules, custody rules, collateral rules, debt management client money rules and mandate rules throughout the period; and

b. Was in compliance with those rules at the period-end date.

9. Part 2 of a Reasonable Assurance Client Assets Report is a schedule of identified CASS breaches that have occurred during the period. The Breaches Schedule sets out all the breaches the CASS auditor has identified through its work and all breaches disclosed to it by the firm or any other party.

10. The Client Asset Assurance Standard focuses on the client money and custody rules. The SUP rules also require the CASS auditor, where applicable:

c. To express an opinion as to whether a nominee company in whose name custody assets of the firm are registered during the period, has maintained throughout the period systems for the custody, identification and control of custody assets which:

i. were adequate; and

ii. included requisite reconciliations; and

d. If there has been a secondary pooling event during the period, the firm has complied with the rules in CASS 5.6, CASS 7A and CASS 11.13 (as applicable to the firm) in relation to that pooling event.

11. Other than for references in the illustrative client assets reports the Client Asset Standard does not establish basic principles and essential procedures with respect to these elements of the report.

Limited assurance client assets reports

12. Some investment businesses may claim not to hold custody assets or client money. In these circumstances the SUP Rules may require the CASS auditor to provide a Limited Assurance Client Assets Report. Such reports are also required to be made annually and to provide the CASS auditor's opinion as to whether "nothing has come to its attention that causes it to believe that the firm held client money or custody assets during the period".

- No additional comment (points are consequential).

Why is it necessary to develop an Assurance Standard?

13. Arising from the 2008 financial crisis there were well publicised cases (frequently involving lengthy and complex litigation) regarding the effective safe-keeping of client assets by, among others, Lehman Brothers and JP Morgan. Since 2008 MF Global collapsed whilst being responsible for the safe-keeping of its clients' assets.

- The events of 2008 were the result of the previous twenty-five years as well as the cover-up of what was really going on. They were already examined by the House of Lords in 2010. Ian Powell of PwC was told he was not believed when he said that the way to deal with a hole was to continue to print money i.e. it was a liquidity crisis that more cash would solve.

- There is no point in the FRC coming five years after the House of Lords Select Committee reported to revisit its work nor to attempt to tackle 2008, after the six year limitation period has passed and victims cannot file for relief. It is too late.

- In 2010 the FRC got together with the FSA on the subject of prudential assurance reporting. There was a public consultation jointly between the two. There was extensive quality evidence provided. The FRC has removed this from its website. It needs to recover it, put it back on the website and consider its "relationship" with the PRA, the more important of the two bodies, as subsidiary of the Bank of England. The FRC should be able to answer:

  - what happened to the prosecution backlog at the time of the separation of the FSA into component parts (PRA and FCA)?
  - what are the consequences of the PRA having no prosecution powers (unless someone is untruthful in dealing with it)? What has happened to the accumulated untruths to the FSA at the time of the split?
  - why are bans, fines and scapegoat trials considered acceptable surrogates for routine prosecution and disgorgement of illicit gains?
  - what are the sanctions faced by auditors of so-called "IPs" ("insolvency practitioners", a made-up and meaningless term) and those purporting to be solicitors to the court but in fact operating without judicial standing in the transactions they facilitate and underwrite? Similarly for those purporting to be a statutory auditor but in fact operating mixed models which contaminate independence and preclude proper assurance reporting?

- Until the FRC recovers the 2010 evidence and goes through both this, the work of the House of Lords Select Committee; the OFT; the Parliamentary Commission on Banking Standards; the results of evidence on IPs; and its own relevant consultations such as on its reform; it will not get a grip on its own activity arrears. A five year backlog is too great.

14. In response to the 2008 crisis the FSA (the predecessor to the FCA) considerably tightened its Client Asset Regime particularly its enforcement of the Regime through the work of its Client Asset Unit which it formed in 2008.

- The FSA is not the predecessor of the FCA. The PRA plus the FCA plus the PRA's prosecution powers it has now lost as a subsidiary of the Bank of England comprised the FSA. In this disembodied form and disabled from prosecutions, the FSA was closed without replacement. The legacy is of two inflated pay-rolls, an expensive palace in Docklands and no identifiable purpose save to block accountability by banks, insurers and their auditors.

15. Since 2008 the FSA/FCA has fined a number of financial institutions, such as Barclays Bank plc and Aberdeen Asset Managers Ltd, in connection with significant breaches of the CASS rules.

- That is a domestic matter between them. It is the equivalent to the BIS legal team boasting that they jailed someone for two years for a £1/2m contravention as being their great success, justifying a head count of two hundred and fifty (they say). There was no mention of damages to the victims or what they would do with a £50m or £500m scam.

16. In 2010 the Auditing Practices Board of the FRC concluded that although the development of CASS Assurance Standards may be ultimately desirable that it would be expedient to develop guidance for CASS auditors. The development of guidance was considered to be expedient for two principal reasons:

a. Because guidance can be prepared and issued without the formal consultation process that the issuance of a Standard requires; and

b. The FRC was aware that the FSA was to undertake an extensive review of the Client Asset Regime and that the outcome of such a review might have a significant effect on the nature of the Assurance Standards that the FRC should issue.

- 2010 was the year of the House of Lords Select Committee on the complicity of the purported auditors with those they purported to audit and the fact that the collapse was the predictable consequence of the previous era. The APB of the FRC, a body which is not elected, was wasting time by not being in Parliament understanding the evidence and working out what to do about it. This is a five year back log in vital work. Developing guidance rather than enforcing existing standards because "*consultation can be avoided*", in particular with the victims under the Equalities Act, speaks for itself and means that any outcome will not survive judicial review. The FRC has no known budget for time in the Administrative Court or for paying damages which the courts are prone to award, taking the view that statutory bodies should know better (CPS, SFO), seemingly regardless of discernible cause of action.

17. In October 2011 the FRC issued Bulletin 2011/2 "Providing Assurance on Client Assets to the Financial Services Authority" and in March 2013 issued Bulletin 3 "Providing Assurance on Client Assets to the Financial Services Authority (Supplement addressing the use of Third Party Administrators)".

18. In July 2013 the FCA issued a Consultation Paper "Review of the Client Asset Regime for Investment Businesses". The results of this Consultation were published in June 2014 in the FCA's Policy Statement 14/9. All of the revised CASS rules and Guidance come into force between 1 July 2014 and 1 June 2015.

19. In the context of the issuance of the FCA's revised CASS rules the primary objectives of the FRC in developing an Assurance Standard to supersede the extant guidance is to:

a. Improve the quality of CASS audits;

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;

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;

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;

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

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

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

Future changes to FCA Rules

20. The FCA's rules change from time to time. The proposed Standard has been drafted on the basis of the current CASS sourcebook but taking account of the changes to CASS 6 and 7 introduced by Policy Statement 14/9. If any further significant changes are introduced by the FCA over the next few months, e.g. in relation to CASS 5, the FRC will take these into account before issuing the final Standard.

Status of the Standard

21. This Standard would be the material referred to in SUP 3.10.5B G to which the FCA would expect CASS auditors to have regard for reports issued on or after the effective date.

Equalities Act

- Unless the FRC completely identifies the victims of the FSA/FCA's "*CASS*" scheme and the (contingent) assets involved; the shortcomings in current compensation schemes; the contamination by the vested interests in the schemes' implementation; the path of using the courts rather than compensation that is ineffective; the quantification of unbooked contingent liabilities; the political appetite in regard RBS and Lloyds, together with the financial interest of the "*advisers*"; it is not in a sufficiently informed position to be able to consult under the Equalities Act. Accordingly any standard would not survive judicial review. The FCA will continue not earning a living.

Invitation to comment

1. The FRC is requesting comments on this Consultation Document by 31 July 2015. The FRC is committed to developing standards based on evidence from consultation. Comments are invited in writing on all aspects of the Consultation Document. In particular, comments are sought in relation to the questions set out below. Please give reasons for your answers.

2. Further information concerning the submission of comments is on page 76.

- Standard setting has gone adrift. It has acquired the characteristics of being the manufacture of product rather than the application of existing standards to areas that have been a cause for concern. Examples are the lack of independence of the former statutory auditors and financial statements which do not reveal the identity of counterparties or evaluate counterparty risk. There are elements of deja vue for those living through sovereign risk debt provisions in the late '80's as statutory auditor including tax auditor. The organized driving out of small and medium sized auditors and raising of the statutory audit threshold, together with anonymising companies house returns has created an opportunistic free-for-all, leaving the FRC as an irrelevant white elephant most people have not heard of, let alone believe does anything useful. Its persistence in silo operations and reliance on employing those coming from the vested interests leaves it vulnerable to comments on lack of independence which it would find hard to refute.

Policy

- The word "policy" has crept into the FRC vocabulary and indeed its internal organization, job specs/titles, and recruitment. By definition assurance reporting and independence verification precludes any consideration of policy save as a threat to independence. The FRC needs to conduct an urgent review of itself and to purge any such reference. It should make its statement of independence from government in flashing lights on its website and other printed materials and publicly report without being asked on any meetings with government officials in particular those in policy. There ought to be a published list of all contracts with outside suppliers with full terms and conditions as well as the experience which these purport which led to the FRC hiring them. There is no point taking about independence and turning around and doing the opposite such as hiring barristers to speak in public who are not competent not least because they are not members of assurance reporting bodies liable to sanction if they get it wrong.

- The FRC has been embarrassed by (i) Tim Dutton who invented the term an *"honest mistake"* to replace reckless and knowing conduct in contravention of FSMA 2000 and the Theft Act); (ii) private sector lawyers who have infiltrated BIS and introduced *"honest creditors"* to justify the asset strippers and those stealing judicial standing with the right to enforce as established in court. It has provided its beleaguered agency the Insolvency Service to help the side it ought to be curtailing; and (iii) the FRC's own representation in the Administrative Court who explained to the judge that *"an auditor is a subset of the accountants"*. It appears impervious to such embarrassment let alone show willing to correct.

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. Paragraph 9 is reproduced below for ease of reference in replying.

In the context of the issuance of the FCA's revised CASS rules the primary objectives of the FRC in developing an Assurance Standard to supersede the extant guidance is to:

FRC – supervisor brings obligations

- The FRC is a statutory body. It has obligations enshrined in law, as supervisor of other statutory bodies with members. All its activities must by law be focussed on discharging its obligations to the public to protect them. There are two sides to such protection. The first is by a copper bottom guarantee of the duties of the members of these bodies severally. These have not changed since 1880 when ICAEW came into existence. This means that it must prescribe the path where there is a contravention, without burden on the victim. It can only do so if it is independent. It cannot be independent if its directors and staff come from the vested interests from whom it must protect the public nor where its chairman is a political appointee. Law enforcement is based on Parliament and the independent judiciary only.

- Making up an adversarial trial or tribunal with a view to getting rid of the victim or complainant does not do it (protection from retaliation is required) nor does pointing to BIS. This is encumbered by an unelected largely anonymous bloated payroll of "lawyers" who have metamorphosed from the private sector without the knowledge or experience to perform as a civil servant or manage public money. The effect has been to contaminate irreparably and irreversibly the discharge of the duties of the state. Experience and knowledge of long term civil servants from the days of DTI inspectors has been driven out under the guise of *"voluntary exits".* The closure of the OFT and exclusion of Trading Standards and Citizens Advice Bureaux has left the public including entrepreneurs and SMEs highly vulnerable.

Transparency in supervision

- The second is by ensuring that its supervision is transparent and includes collecting that data that enables the public to access under FoI the information they need to protect themselves from the vested interests including those who are members of the bodies which are supervised. It means that accredited members must carry and use personal IDs; provide service address; and that agreements that they enter in their own operations, including funding arrangements, are publicly accessible at no fee including for those retired. Members bodies should not be allowed to purport to speak for their members when in fact they have not consulted them at all and may indeed have gone to extreme measures to silence them.

• Neither the "CASS rules" nor any other product created to allow the staff of another body such as the FCA to do no work but to draw a wage, can be allowed to deflect from delivery of these mandatory obligations. The FRC has the live experience of the FSA's 2012 compensation scheme designed to stop the victims of mis-selling from suing by the statutory dead line of six years and thereby *"protect"* the seller from come-back. The loss of opportunity to the economy and in flows of revenue to the Exchequor and HMRC is unquantified. The FRC by seeking to align itself with the FCA is voluntarily giving up any semblance of independence and implicitly condoning each of the mis-selling and blocking of accountability. Such interference between private entities cannot be condoned and is well outside its powers.

Compensation

• An effective discharge of its duties in this regard would have been to represent the victims in a show-down with the purported auditors of the entities mis-selling on the grounds of complicity and false accounting in regard contingent liabilities, (i.e. either a counterparty or third party (contingent) asset). The FRC should have told the public that compensation schemes executed under the control of the vested interests was not a surrogate for suing and that deals between the Treasury and the FCA as to who could be excluded meant that contingent liabilities were knowingly understated, thereby increasing counterparty risk to all customers regardless of transaction. It can expect the spotlight on its passive stance in circumstances where only £1.9b has been paid out; £4.5b accrued; and £30b estimated.

• It must be ready to explain in public evidence that those vested interests operating the scheme preclude themselves from the audit of the sector on grounds of fatal loss of independence. It must also explain that for the same reason it cannot get involved in the manufacture of "standards" for the FCA or any other body that has yet to be fully held to account not least for a cavalier approach to the protection of the public.

https://www.youtube.com/watch?v=oIdqraQfXMU&feature=youtu.be Andy Verity Newsnight 24.7.15

• There is currently no accountability on the FRC in regard its annual budget and the loss of opportunity to the economy from the control the vested interests have over activity such as compensation schemes; "skilled" persons activity; "enforcement"; and each of the members' bodies together with influential government posts, the effect of which has been to drive out those who have the experience and the respect of the public, Parliament and independent judiciary. The FRC has yet to explain how it is that (i) BIS has generated and boasts of a legal department of two hundred and fifty operating to eradicate independent and transparent assurance reporting; and (ii) the Chief Inspector of Companies, Companies Investigation Branch and OFT have all disappeared. Its explanation must include why this legal department believes that any person can avoid the need to prove a contingent claim against another and can use its agencies to liquidate a target, realizing value for the vested interests outside the scope of UK tax reporting whilst the machinery of state operates to ensure the victim is never heard as though the public order acts did not apply to them.

- The key criteria in regard evaluating this proposal (should it survive any further) are:

1. independence of the auditor (including competence and experience);
2. mandatory resignation where there is a loss of independence (citing reasons);
3. exceptions based risk reporting fatally contaminating assurance reporting;
4. exclusion of counterparty identity and risk;
5. outcome based accounting fatally contaminating contingent risk reporting;
6. cross-referencing to other standards, evaluation on the income statement and balance sheet, other reports and checking there is no outside contradictory evidence;
7. lack of transparency in internal controls audits;
8. contamination of the independence of assurance reporting by "policy" which has no place in assurance reporting; and
9. depriving the reader of a set of accounts of that information that they need to make a decision, eg, to accept a job, to supply, to hire or agree tax returns.

a. Improve the quality of CASS audits;

- A *"CASS audit"* is identical to any audit. Auditing and assurance standards would be reduced to an absurdity if they randomly changed in substance with the latest fashion. The best that guidance and technical support can achieve, is to explain jargon and to show how the reportable event can relate to existing standards. Accordingly there is no such thing or person as a CASS audit or a CASS auditor per se. "*Quality"* is a meaningless term in the context of assurance reporting. A record or report is either right or wrong.

- The experience and dangers in regard Client Monies and other transactions involving participation by the notional *"auditor*" are the relevant benchmark. The public has not yet recovered from the FRC's Tribunal against PwC in respect of JP Morgan mixing of Client Monies (implicitly condoning such complicity, rather than permanently curtailing it), or that in regard Farepak where there was upfront profit taking by Barclays Equity on the public market and a *"pre-pack"* to block come back before the six years under the statute of limitation. Recently the FRC has been held to account in the Administrative Court on purporting to be prosecutor and judge on its Tribunals as well as depriving those it takes to such a forum of the rigours of the opportunity of a defence in the crown courts in regard serious matters, such as complicity with false accounting and the manufacture of forged statutory records with consequences on market notification. The sooner these end the less the damage from such random interference between private entities and each other.

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;*

Independence of the statutory auditor to plan his own work

• A statutory auditor is required to design and carry out those tests which give him the assurance to enable him to report. His working papers are owned by him. He reports as he sees fit. There is no such concept as *"challenging"* him, since his own challenge is in-built into the audit process. *"Judgment"* relates to matters such as estimates of accruals and contingencies. A decision not to report on identity of counterparties and counterparty risk means that financial statements are misleading by omission. The sooner the FRC bites the bullet on this issue and compels notification, the greater its chances of survival.

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;*

• The FCA is more than adequately funded that it can do its own work. This area should properly be more the concern of the **PRA** rather than the FCA. There is no such thing as a *"regime*", a term which has crept into bankruptcy law ("*insolvency regime*"). The PRA has bemoaned it has no influence over compliance officers and that these by definition cannot be independent. Assurance reporters must evaluate and report on such risks.

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;

• **Expectations management** plays no part in a statutory audit.

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

• **Training** is a matter for an employer. Without experience, an auditor cannot be part of the relevant team. The FRC has no statutory empowerment in training and should remain silent on the subject. The experience of those it employs and its relevance to their work is within its range of concerns. Outsourcing core business is not acceptable.

> *f. Help to establish realistic expectations regarding the integrity of the UK Client Asset Regime with the beneficial owners of client assets; and*
> *g. Underpin the effectiveness of the FRC's enforcement and disciplinary activities with respect to CASS assurance engagements*

• The **FRC's disciplinary activities** have hit the skids. They cannot conduct Tribunals as judge as well as prosecutor nor can they focus on *"serious"* issues, for which the Crown courts operate. They have been slow to give them up and find a more effective way to curtail wrongdoing and fast-track recovery and disgorgement of illicit gains.

• The **legal and beneficial owners** of client assets and contingent assets, customers or not, require a copper bottomed guarantee they will recover, within their life-time and within limitation periods without burden of recovery. The FRC has not come up with a way of underwriting such an outcome.

> *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?*

• If the audit of client assets is not already covered (including contingent assets of customers and counterparties), the PRA/FCA/BoE/BIS/FRC should be seriously worried and someone should tell Parliament and the public. The proposal is at best redundant, at worse obfuscating, distracting and misleading. It will alienate entities from their auditor.

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?

- There is no such person as a "*practitioner*". There is an independent statutory auditor who is an office holder. The inference of this paragraph is that the work of the statutory auditor comprises form filling and the exam question is *"which form should be filled in?"*

- The "*structure*" of a standard is irrelevant to its content. The audit of client assets is already part of any normal audit. There is no gap to be filled by a new standard.

- The risk that the FRC faces is that to its own credibility. It cannot by the mechanism of manufacturing a standard create any form of comfort for the FCA. The FCA must do its own work or shut up shop and find something else to do. The FCA (as indeed the PRA) has not as yet managed any path for external whistleblowers as the Parliamentary Commission on Banking Standards told the FSA was required. For internal whistleblowers, the effort appears limited to hiring extra labour and locking people up in a call centre with nameless operators, loosely and confusingly tied to employment law, which sets out to silence and discredit the whistleblower and bury the default however irregular or unlawful.

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.

An auditor shall report: reciprocity in duty of confidentiality

- The directors severally are compelled to give unfettered access, information and explanations, to the statutory auditor. In turn these must report to these directors severally who must publish such reports. The auditors' formal reports are published by the directors' severally and in their name, since it they severally who must appoint the auditor (or ensure the shareholders do) and they who sink or swim on the veracity of such report. In other words the directors severally carry the can for that which they do not control.

- Letters to management and letters of engagement are not public but are part of the internal machine for getting to the right result. They remain confidential as between the parties. They cannot be used in court unless there has been a reasoned judgment capable of appeal as to why the mutual duty of confidentiality may be broken. Any judge would be extremely cautious in such a judgment as it threatens the bedrock of unfettered access, independence and proper reporting. Its effect would be that the law applies unless an amenable judge says otherwise. ECHR will not over turn such judgment on the (unsatisfactory) grounds of not wishing to be seen to interfere in domestic operations of law.

- Once this reciprocal duty has evaporated, a regime of perceived self-interest takes over. Devices as pre close statements take over, essentially attributable to no-one. The auditor's report with the financial statements is reduced to a product and advertising space is bought in Companies House, a copy of which the public pay to purchase.

- Accordingly the existence of a reciprocal duty of confidentiality is fundamental. The statutory function collapses into mistrust where such reciprocal duty is contravened. Independence is lost. All bets are off on the outcome where this occurs *("uncertainty")*.

Direct reporting to the FCA: no proper letter of engagement can exist

- Direct reporting to the FCA means that the audit team has a spy in the camp. The FCA should not be so lazy that it expects others to do its work or seek to promote secret activity in insider information. An auditor intent on reporting to the FCA (rather than to the directors) would not be let past the front door of any self-respecting enterprise (nor, if they wanted to keep the job, would the auditor even ask).

- The reciprocal statutory duty of confidentiality which applies by virtue of public duty reporting; Companies Act; FSMA 2000; DPA; Human Rights; independence obligations is non-negotiable. A statutory auditor has legal right of unfettered access: it is an offence to obstruct. Likewise it is an offence not to report properly including on a timely basis or otherwise resign with reasons. There is no proper mechanism that this statutory entitlement to access can be used for another purpose, including to *"stitch-up"* the directors with those with prosecution obligations, in the event the auditor himself has defaulted. The independent judiciary describe what can be predicted to emerge in such circumstances as *"Kafkaesque*".

Representations by statutory auditor to the FSA/ other third party prosecutors

- A purported statutory auditor loses his independence and cannot report where he makes representations to third parties, secret or otherwise. Effectively these are made in the name of the directors severally even where these do not know and cannot control what is being represented. If he attends an AGM (private shareholders meeting) he is limited to reading his report. He becomes a shadow director as well as contravening statutory duties of confidentiality. A direct cause of action is created between each of those concerned and those in whose name they purport to speak. The statutory symmetry that unfettered access to information and explanations compels proper reporting so long as independence is preserved is gone. The FRC should intervene in support of directors but does not for no good reason.

Engagement Quality Control Review

4) 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?

Audit planning

- The draftsman appears to believe that (s)he has embarked on the manufacture of a new product, being a *"CASS audit*" and a new accreditation being that of a *"CASS auditor"*. If the scope of this proposed new standard is not already included in a statutory audit, the purported auditor should be asked the question by the FRC, *"why not?"*

- The statutory auditor must plan his audit to ensure he gets to the bottom of the true position against which to judge the estimates in the draft financial statements and manage risk. He must operate independently i.e. unfettered. This suggestion or proposal for a new standard smacks of an attempt at random micro management.

- The *"views*" of the FRC play no part in the process of enforcing and maintaining standards nor is it clear that a statutory body is capable of forming a *"view"*.

Ethical requirements

5) 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.

Ethical standards for assurance reporting

• Ethical criteria apply to all members of the bodies which can provide such accreditation. They apply to the individual. Therefore they cannot be varied according to task. Contraventions of ethical standards are sufficient to give rise to permanent exclusion. In other words they are non negotiable and implicit in all activity. It is alarming that FRC staff should be even raising doubt on such basic points of assurance reporting.

Requirements relating to training of CASS auditors

6) 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?

Independence not "mind-set" the required criteria

• "*Mind-set"* is not a known concept or principle in the performance of a statutory audit. A statutory auditor is required to validate independence prior to offering to take up office and must resign with reasons when loss of independence arises. Independence includes commercial independence; relevant experience; and access to sufficient explanations and information that the statutory duties can be fully discharged on a timely basis.

Criteria for the standard-setter

• The identical standards apply to the standard-setter. In particular a standard setter who is not manifestly independent of those judged by those standards is not independent. Those crafting the standards must themselves be judged by the same criteria. They must show that the basic principles of direct reporting are those that applied from the nineteenth century and that no form of alternative assurance report can be a sufficient surrogate.

• Training is irrelevant as it is insufficient. Previous experience is relevant. An auditor relying on training without relevant experience cannot properly be a member of a team.

Communicating deficiencies in internal control to management and the governing body

7) 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?

- The law provides that "*an auditor shall report".* This means to those charged with the governance of the enterprise being its directors. There is no concept of *"in contrast"* between one part of the audit and another. The testing of internal controls will provide its own steps to be taken after a weakness is identified, depending on the nature of the weakness/exception/error. There is no mechanism by which the FRC can *"double-guess"* the work of the statutory auditor in devising those tests and running them, to satisfy themselves that the control environment exists and works such that proper records have been maintained and that sample testing can be used rather than 100% substantive testing.

- There has been a worrying drift to asserting that the reports in financial statements are those of an "*independent"* auditor, such independence asserted rather than being certified. There has been a similar drift to purported auditors asserting that they have carried out a statutory audit *"in accordance with auditing standards"* implicitly as an alternative to performance in accordance with the Companies Act. In addition adverse reports on grounds of financial uncertainty and non compliance with the Companies Act have metamorphosed into qualified reports: by definition if one does not know, the basis of valuation of estimates in the draft financial statements cannot be ascertained at all, let alone with any degree of confidence. Financial dependence on discretionary powers of third parties means by definition the entity is financially unstable with unpredictable results. Reliance on bail-outs or compensation schemes for insurers is notifiable with an adverse report where not notified.

- Finally the reference to *"matters which may come to the auditor's attention*" suggests that the draftsman of this section believes that the planning and execution of a statutory audit is haphazard and limited to that which has been put under the auditor's nose. That itself is of concern in particular where such a basic misconception comes from the FRC in a formal public consultation. The infiltration of public accountants by those seeking to contaminate the integrity of their independence in the performance of public duties has had many manifestations. One of these is *"notice"* i.e. that the purported auditor is permitted to report on that which is put under his nose and may, with purported impunity, ignore the rest.

An independent auditor reports on themselves

- The office of auditor can only survive in any meaningful way, if the auditor is independent and reports on his own work. If he is reduced to reporting on that which is put under his nose, he performs a rubber-stamping operation and does not discharge the duties of statutory auditor. There is currently no certification of independence verification or publicly available criteria against which such tests must be run. This means that charletons and rogues masquerading as statutory auditors are able, with purported impunity, to lapse into sloppy practice such as sending out emails during business acceptance, leaving it to recipients as to whether they reply or keep quiet. "*Virtual firms*" means that those with the knowledge may well have become contractors (called "*consultants")* or retired leaving no trace.

The risk of made up statements and reports

- The popular negative adverse reports that (gist) *"in the course of carrying out our work nothing has come to our attention that warrants an adverse report"* has gone a long way to discrediting the industry. Implicitly it does not inform whether the purported auditor has looked or not. The combination of (i) limiting reporting to "*notice*"; and (ii) reporting without confirming having looked, is toxic. It gives no comfort that the *"accounts"* inclusive of *"auditor's report"* have not just been made up. Positive reporting, like the annual service of the gas boiler or MOT test on a vehicle, is that which is required. It does not currently exist.

Rule breaches: FOS

- The FRC has no statutory obligation in this regard, save indirectly in that it is the supervisor of members' organisations, whose members are the internal and external auditors of the Financial Ombudsman Service (FOS). FOS is required to protect the public and give relief when FSA licensed activities do not deliver. A *"complaint"* to FOS should properly give a recital of the rules which have been breached and compensation or specific performance requirements imposed on the defaulter. FOS should report to the FSA/FCA/PRA.

- In practice this does not happen. The staff of FOS are ignorant of the business rules. They do not use them to evaluate the delivery of licensed operators. They make no FSA (/FCA/PRA) referral or referral to Trading Standards. They give the objections and complaint to the defaulter and refuse to provide what they receive. They inform the sufferer that if the product has not delivered, there is no recourse but to issue proceedings. By that stage it is too late. FOS's income comes from those they "*challenge".* They are accordingly not independent. Their Chief Ombudsman is not accessible. Failure is rewarded by moves to other important posts. The victims are left behind, voiceless and forgotten.

- The FRC has not held the internal or external auditors to account or examined the relationship between them. Complaints to FOS involving either can be predicted not to see the light of day. Consumers and the public, including company directors, are unprotected.

Reviews including "*skilled persons reviews*"

- Such reviews are public functions as are compensation evaluations under the 2012 FCA redress schemes for those mis-sold product. It follow the decision in the Administrative Court that KPMG hired by Barclays to deal with compensation for mis-sold product, was undertaking a public function and could be the subject of judicial review.

- The position has recently been further clarified, *(30 July 2915) [2015] EWHC 2277 (QB) Suremime Ltd v Barclays Bank plc,* that the implementation of the compensation schemes itself is actionable. Limitation issues can be overcome. The £1.9b compensation paid so far is a fraction of the £30b estimated. The FRC needs to consider carefully its approach to the accounting and auditing of contingent liabilities which in the books of the financial services vendor is a contingent asset of a third party, or client as the case might be.

- No emergency guidance has been publicly issued by the FRC to the auditors of such organisations and should have been, given the sell-off of RBS and Lloyds with the voiceless public once again lined up to pay the cost and vested interests skimming on the transactions.

Public duty

- The public duty essence of the activity of those bound by proper assurance reporting criteria has not been tackled as a subject per se, although at the time of the formation of ICAEW by Royal Charter in 1880 it was chrystal clear. This followed the jailing of the Bank of Glasgow directors for false reporting (1879). The FRC ought to review how far operators have gone adrift since 1879 and what its duties to the public are in regard such de-railing.

"Skilled persons"

- The FRC wishes to exclude *"skilled persons reviews"* from this current exercise. It makes no sense to make exceptions. The FSA/FCA have bemoaned their lack of expertise. However their approach to procurement of external resource does not stand scrutiny; is not independent; and is considered to be no more than a mechanism to bury what is inconvenient whilst discrediting the witness who brought the evidence to them. There are no meaningful statistics as FoI responses are depersonalized so no-one knows who benefits.

- Until *"skilled"* is re-cast to mean experienced in the issue highlighted as problematic and the FSA/FCA either resources its work from internally, or externally but not from the vested interests or those undertaking statutory audits, the result will always be unsatisfactory and not independent. The FRC needs to be careful that its own resources are likewise independent and accredited to the same assurance standards (i.e. can be disciplined in regard their own FRC work using the identical criteria they seek to enforce on others).

Tribunals

- The criteria that would cause the FRC to take a defaulting auditor to Tribunal have not been specified nor has the path been defined for a person suffering loss or damage. Likewise the prosecution path has not been mapped out.

Reporting to management

- *"An auditor shall report"* means to those charged with the governance of an enterprise i.e. the directors severally. In a public company for an important issue (notifiable) no more than a half day delay is considered acceptable, since an announcement may be required.

The firm's *"governing body"*

- The directors severally carry the responsibility for the maintenance of proper records; reporting; and publishing during their period of office, measured in full periods of account. There is no higher "*governing body"* or one that effectively usurps the duties of the directors severally. There is no proper mechanism by which the FRC can create a reporting line from inside an enterprise directly to the PRA/FCA or indeed anywhere else. Market notification is a matter for the directors severally and not the FRC.

witness
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