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Our ref

rf

31 July 2015

Dear Mark

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

We are grateful for the opportunity to comment on the FRC's Consultation on a new Assurance Standard relating to Providing Assurance on Client Assets to the Financial Conduct Authority ("the Consultation Paper").

We have responded to the specific questions in the Consultation Paper in Appendix 1 and set out certain other comments in Appendix 2. We have also provided drafting comments in Appendix 3. If you wish to discuss any of the points raised, please contact me on 020 7694 2499.

Yours sincerely,

Richard Faulkner
Partner, KPMG LLP

Enclosures:

Appendix 1: Responses to specific questions raised in the Consultation Paper

Appendix 2: Other comments on the Consultation Paper

Appendix 3: Drafting matters

Appendix 1: Responses to specific questions raised in the Consultation Paper

Note: For ease, we have referred to the annual reporting to the FCA as required by SUP 3.10 of the FCA's sourcebook as the "CASS audit" and the firm performing such work as being the "CASS auditor" or the "audit firm". The term "firm" is used to describe the regulated entity that is subject to the CASS audit.

Question 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?

We are supportive of many of the objectives of the proposed Standard as set out in paragraph 19 and welcome the introduction of an assurance standard that provides a framework within which a CASS audit and the provision of certain other reports to the FCA should be performed. We are however concerned that the proposed Standard, as currently drafted, falls short of the objectives set out in paragraph 19 of the Introduction in certain instances and that, in other instances, the objectives are not relevant and/ or understandable. We have set out our reasoning for this in the table below:

	Objective	KPMG comments
a)	Improve the quality of CASS audits	<p>The current APB Bulletin provides considerably more guidance as to what procedures a CASS auditor may be expected to perform than the proposed Standard does. We believe that CASS auditors should use their professional judgment and interpretation of the CASS rules to perform their audits. However, we feel that the absence of further guidance in the proposed Standard could lead to inconsistent practice across the audit firms performing CASS audits and, as such, the proposed Standard could fail to achieve its objective of improved CASS audit quality as a whole. Further, such guidance would be of benefit to smaller CASS audit firms that may not readily be able to call on the cumulative knowledge and experience of CASS subject matter experts when developing procedures to plan and deliver CASS audits.</p>

b)	<p>Adequately support and challenge CASS auditors when undertaking CASS engagements and, in particular, to define the nature and extent of the work and effort required for both reasonable assurance and limited assurance CASS engagements without undermining the importance of the CASS auditor's judgment</p>	<p>Broadly speaking, we believe that the proposed Standard does support the CASS auditor in defining the nature and extent of the work and effort required, subject to the following:</p> <ol style="list-style-type: none"> 1. Our observation on the inclusion of further guidance as noted above 2. Special reports (Paragraph 168) - Relative to the very prescriptive instructions around Limited Assurance engagements the guidance supporting 'special reports' seems very minimal. <p>This seems to put the CASS auditor in a very difficult position as the FCA indicates the FRC sets out the guidance, the FRC gives some very high level guidance but no detail and the Reasonable Assurance opinion references these very limited instructions as the basis of opinion – this doesn't seem appropriate as to give reasonable assurance there needs to be an agreed basis between the assurance provider, recipient of the opinion (FCA) and the firm over which the assurance is being given.</p> <p>We therefore recommend that the FRC liaise with the FCA in order to decide on who will provide guidance for auditors and the level of detail that this will contain. Subsequently, we believe that the standard should contain wording to define that, as auditors, we will assess the design of a firm's processes and controls and whether or not this is in line with the expectation of the FCA.</p> <p>We do not see how the proposed Standard "challenges" CASS auditors. We would suggest removing this word from the objective.</p>
c)	<p>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</p>	<p>While our role as auditors is important in the wider context of providing assurance to firms over their compliance with the CASS rules, we do not understand how the assurance standard can effectively guard against management not having in place the right processes and controls to ensure compliance with the CASS rules. While we can opine on these and flag them to the regulator through our continuous work, we cannot</p>

		change them or impose on the FCA to investigate them. We would therefore suggest the removal of the words “and in particular to guard against systemic failure of the CASS regime” from the objective.
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;	As a matter of fact, we are not engaged by third party administrators to provide assurance to the FCA. We are engaged by the firms that are required under SUP 3 to obtain a CASS audit or under CASS 6 or CASS 7 to provide special reports to the FCA. We would therefore suggest that (ii) be removed as an objective.
e)	Support the effective training of CASS auditors by both the accounting bodies and other training organisations	The proposed Standard gives limited guidance on what constitutes “effective training”.
f)	Help to establish realistic expectations regarding the integrity of the UK Client Asset Regime with the beneficial owners of client assets; and	We are not sure how the proposed Standard could establish realistic expectations regarding the integrity of the UK Client Asset Regime, particularly with regards to the beneficial owners of client assets, who are not recipients of CASS auditors’ reports.
g)	Underpin the effectiveness of the FRC’s enforcement and disciplinary activities with respect to CASS assurance engagements	Given the comments raised in a) through f) above, we believe that this objective may be compromised as well.

Question 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?

While we believe that it would be possible for CASS audit firms to adopt the proposed Standard at an earlier date, we do not believe that it would be appropriate to mandate the application of the proposed Standard for reporting periods commencing before 1 January 2016 for two main reasons:

- 1 While the proposed Standard codifies a number of areas that may well have previously been performed by the CASS auditor, the proposed Standard introduces a number of new and fairly significant requirements. These include requirements around training (para 36), an evaluation of whether management “seeks to maintain a culture of honesty and ethical behaviour towards the beneficial owners of client assets” (para 83a), an evaluation of the effectiveness of a firm’s Internal Audit and Compliance departments (para 87), an understanding of the sources of information used in the firm’s monitoring activities (para 89) and the inclusion of Engagement Quality Control Reviewers on all Reasonable Assurance engagements (paras 141 to 145).

Introducing a framework to meet all of the requirements of the new CASS assurance standard will be onerous for some CASS audit firms and across some firms and the objectives of the proposed Standard may not entirely be met if the proposed Standard was mandated for periods commencing before 1 January 2016 due to these constraints.

- 2 From a practical perspective, planning for the CASS audits for larger CASS assurance engagements for 31 December 2015 year ends has already started with resourcing and fee discussions being finalised.

We believe that audit firms will be able to fully embed the enhanced requirements into their CASS audit procedures for periods commencing after 1 January 2016 at the earliest.

Question 3: The proposed Standard includes within a single document requirements relating to: a. Reasonable assurance engagements; b. Limited Assurance engagements; c. Special Reports; and d. Non statutory Client Money Trusts. The FRC considered other possible approaches involving issuing a number of separate and shorter Standards. On balance, however, the FRC concluded that including all the requirements in a single document was likely to be the most helpful to practitioners and to mitigate the risk of practitioners, who perform relatively few engagements, from failing to select a relevant Standard to complete. Do you agree with including all requirements in a single Standard? If not, why not and what alternative structure for the Standards would you prefer?

We agree with all the requirements forming part of a single standard.

Question 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.

We broadly agree that the proposed Standard contains requirements that are proportionate to Client Asset Assurance Engagements. We do have comments on specific paragraphs that we have documented in Appendix 2.

On the subject of direct reporting to the Financial Conduct Authority, Paragraph 10 of the International Framework for Assurance Engagements states that for some assurance engagements, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users. These engagements are called "assertion-based engagements." In other assurance engagements, the practitioner either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report. These engagements are called "direct reporting engagements."

It is therefore our understanding that Client Asset Assurance Engagements should not be direct assurance engagements in the first place as the directors of the regulated firm should always be prepared to provide auditors with written representations as to the firm's compliance with the Rules.

If firms are not prepared to provide auditors with written representations then that calls into question their entire governance structure. We believe that the current standard should specify that CASS auditors should only accept engagements if directors are prepared to provide a written representation that, subject to any non-compliance disclosed to auditors, the firm has (to the best of their knowledge and belief) complied with the CASS rules in the period.

Question 4¹: 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?

We agree.

¹ Note that the Consultation Paper contains two questions that are numbered 4.

Question 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.

We agree. This is an established framework under which a CASS auditor can operate.

Question 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?

We agree.

Question 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?

We agree.

Appendix 2: Other Comments on the Consultation Paper

Paragraph 15 discusses the CASS auditor assessing whether the existence of all categories of client assets are being treated as client assets and reported by the firm to the FCA.

This would appear to bring elements of the CMAR into the scope of the CASS audit. Is this intentional? In the past the FCA has been explicit that the CMAR is not intended to be in the scope of the CASS audit. While it might be appropriate to bring this into scope it will have scoping, planning, effort and cost implications and should go through a proper Consultation process.

Paragraph 28 states that the content and wording of the Client Assets Report provided by the CASS auditor shall be as prescribed by the Rules of the FCA and follow the templates in SUP 3 Annex 1R.

As we understand this, this requirement would mean that as auditors we would not be permitted to add our own ‘Bannerman’ type paragraphs without the FCA’s approval. We suggest that more guidance is provided to audit firms as to what disclaimers can be placed into our reports without prior consent from the FCA.

On the format of the template reports, the FRC should consider making them more consistent with ISAE 3000 (albeit this is not a UK assurance standard). For example, these could include reference to the respective responsibilities of the directors and the CASS auditor, and the latest version of ISAE 3000 requires specific statements to be included re independence etc.

Paragraph 74 requires CASS Auditors to formally consider the following sources of information when performing our assessment of the control environment in place

- **Compliance monitoring programmes and results**
- **Records maintained by the firm of any rule breaches and notifications to the FCA that may have occurred during the period**
- **CMAR Submissions**
- **Results of any inspections made by the firm**
- **Register of client complaints**
- **Any Section 166 or relevant external/internal reviews that may have been performed**

Notwithstanding the increased requirements resulting from the mandatory review of the above requirements, we may, as auditors, encounter difficulties in obtaining the results of independent external reviews that have been performed by third party consultants at our clients. We propose that this is kept as a rule in the final draft but with the added caveat that as auditors we can only review what is made readily available to us and not the information and work underpinning the above.

Paragraph 94 requires a CASS auditor to perform walkthrough tests in order to evaluate whether the internal control activities were put into place as designed and to adopt a suitable approach to test the effectiveness of the operation of these controls during the period. In the Definitions section of the consultation paper, a Walk-Through test is defined as “tracing a few transactions through the firm’s systems used to monitor and report on client assets”

In most instances, a CASS auditor will be able to understand the design of a process by walking through a single sample transaction through a firm’s systems. The proposed definition would potentially treble² our work with no added value given that processes and controls for firms with highly automated processes and transactions can be largely homogenous. Where there is a slight nuance in a process or product, we would normally consider that to be separate and would therefore perform a walkthrough on this regardless. We therefore suggest that the definition be amended to read something along the lines of *“Walk-through test: the testing of a transaction through the firm’s systems in order to enable the CASS auditor to identify the key controls relating to that firm’s compliance with the FCA’s CASS rules. Where the auditor deems there to be significant discrepancies between individual transactions, the auditor will use their professional judgment in ascertaining if more transactions need to be traced through the firm’s systems.”*

Paragraphs 94 to 96 require auditors to evaluate whether internal control activities were put into place as designed and whether their operation was effective. Specifically, paragraph 94 requires CASS auditors to, based on the conclusion reached on the design of the control, “adopt a suitable approach to test the operation of these controls during the period.”

Under the International Framework for Assurance Engagements, in an assurance engagement there needs to be suitable criteria against which we form our opinion (eg in financial statements it is the GAAP applied). For reporting on compliance with the CASS Rules, the criteria are clearly the Rules. However, for reporting on the “adequacy of systems...”, it is not clear from the draft Standard what criteria are to be applied. Paragraph 94 refers to design and operating effectiveness of controls, which presumably is part of an “adequate system”. We have used the following definitions of these in arriving at criteria for other assurance engagements which, if this effectively forms part of the basis on which “adequacy of systems” is assessed, might helpfully be included in the standard:

“The controls are suitably designed if: (a) the Firm has identified the risks that threaten achievement of the control objectives set out above; and (b) the controls identified to us as addressing these control objectives would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved.

The controls are operating effectively if, during the period under review, they were consistently applied as designed, including whether manual controls were applied by individuals who have the appropriate competence and authority.”

² We assume that the proposed Standard’s use of the phrase ‘a few transactions’ means that at least 3.

Criteria for determining adequacy should be included in the Standard to help achieve a consistent approach to CASS audits. There should also be criteria for the limited assurance reporting.

Paragraph 110 of the standard states that Assurance procedures are designed in a way that treats the Third Party Administrator (“TPA”) as, in effect, an integral part of the firm. In support of this approach SUP 3.6.1R and SUP 3.6.7G require the firm to ensure that the auditor has access to books, accounts and vouchers of the firm held by its TPA and has the co-operation of the TPA.

We believe that the wording in this guidance paragraph needs further strengthening to clarify that where the statutory and CASS auditors are different, the former needs to ensure that its firm’s agreements with TPAs encompass the same terms to have access to books, accounts and vouchers as provided to the former.

Paragraph 112 requires the “CASS auditor to consider its position” where contractual provisions over rights of access are not in force between the firm and the TPA.

The FRC should provide further guidance on the steps that the CASS auditor should take when faced with these circumstances.

Appendix 3: Drafting matters

We set out below certain drafting matters that the FRC may wish to consider:

- 1 **Introduction Paragraph 10:** Currently, only CASS 6 and CASS 7 are mentioned and we recommend that the standard also include the other CASS rules that are in-scope for assurance engagements.
- 2 **Paragraph 12:** The document mentions ‘responsible individuals’ in this rule but does not define who these are in an organisation. We recommend using the FCA designated definitions of such individuals.
- 3 **Paragraph 20:** We recommend that the standard define the phrase “represent compliance”
- 4 **Paragraph 36 and Paragraph 91:** Both of these paragraphs specifically call out individual procedures or documents that are of relevance to CASS auditors such as client asset reconciliations or trust status letters. It is unclear why these are the only such items that are identified as being necessary to consider in these paragraphs. For example, in paragraph 91, why not also consider custody agreements as well as trust status letters.
- 5 **Paragraph 47:** This paragraph should read as one sentence.
- 6 **Paragraph 176:** It may also be worth including in the guidance that the rules allow for funding advances to be made to insurance companies as well. This would normally be expected to arise in situations where an insurance broker has paid a claim/premium refund to customer before obtaining the money for the insurer. This is contained in CASS 5.4.8R(1) and 5.4.1G(1).
- 7 **Paragraph 177** states that “CASS 5.4 does not permit a firm to make advances of credit to itself out of the client money trust. Accordingly, CASS 5.4 does not permit a firm to withdraw commission from the client money trust before it has received the premium from the client in relation to the non-investment insurance contract which generated the commission.” This is a copy of the current CASS 5.4.1G (2). The FRC should consider removing the second sentence of this paragraph on the grounds that it does not appear in the updated CASS 5.A 4.6.
- 8 In paragraph 10 of the “**CONTEXTUAL MATERIAL TO THE CLIENT ASSET ASSURANCE STANDARD**”, we believe that this should be enhanced to state that there are also other relevant chapters in the Sourcebook (1, 1A, 9, 10, 12, etc...)