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Dear Mr Babington,

26 September 2019

Proving Assurance on Client Assets to the Financial Conduct Authority: Consultation on the proposed revisions

Thank you for the opportunity to comment on the Financial Reporting Council's ('FRC's') proposed revisions to 'Providing Assurance on Client Assets to the Financial Conduct Authority' ('the Assurance Standard').

Whilst we welcome the FRC's outlined approach to making non-substantial amendments to the Assurance Standard, reflecting the time it takes to embed the Assurance Standard in the sector, we are concerned that, as drafted, the changes proposed are significantly more substantial than the FRC may have intended. We have the following significant concerns about the proposed changes to the Assurance Standard:

Extension of scope — the draft amendments expand the scope of the CASS assurance engagement in two key respects; the creation of reporting obligations to those charged with governance, including a requirement to obtain sufficient audit evidence to support such a report, and reporting to the FCA on the completeness of breaches reported by CASS firms. The CASS auditor's obligation is to report to the FCA, in accordance with SUP 3.10 of the FCA Handbook, whether the CASS firm has maintained systems adequate to allow it to comply with the CASS rules during the period and whether the firm was in compliance with those rules at the period end. In addition, auditors have a statutory duty to make a direct report to the FCA in certain circumstances. The proposed amendments to the Assurance Standard in paragraphs 37, 53, 95 and 135 and in paragraph 37 of the contextual material impose reporting requirements that are beyond the scope of these obligations and the CASS assurance engagement. As we have explained in Appendix 1, we recommend these proposed changes are removed from the revised standard.

Engagement Quality Control Review — we are concerned that the proposed 'two-tier' approach to Medium and Large CASS firms, and Small and Unclassified CASS firms does not appropriately address the CASS assurance engagement risk specific and inherent to each category of firm. We do not believe the requirements of the Assurance Standard should vary depending on the size of the CASS firm.

Further information about these and other concerns are set out in Appendix 1 to this letter.

We would like to add that we welcome the removal of duplicated material from the draft Assurance Standard, as well as the updates to reflect the changes to regulation and the scope of the CASS regime since 2015. We also support the inclusion of the requirement to specifically consider the use of information technology insofar as it supports the application of the CASS rules and clarification that

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CASS audits should be finalised on a timely basis and no later than the time period permitted by ISA (UK) 230.

If you have any questions about this response or would like any further clarification, please contact me either by telephone on or by email as detailed below.

Yours sincerely

**David Fenton /4
RSM UK Audit**

RSM UK

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Appendix 1

1. Expansion of scope of CASS auditor's responsibilities

We have concerns about the following proposed revisions which we believe significantly expand the scope of the CASS auditor's responsibilities:

- "The CASS auditor shall communicate to management and those charged with governance on a timely basis, deficiencies in internal control that, in the CASS auditor's professional judgement, are of sufficient importance to merit management's attention. In reporting to management and those charged with governance, the CASS auditor will report those issues which, in the CASS auditor's professional judgement, pose the most significant risk of non-compliance with the CASS rules, and which require the most urgent resolution" (paragraph 135, with similar amendments to paragraphs 53 and 95 (not presented)) ('Revision 1');
- "The procedures to be performed shall be sufficient to address the engagement risk, and to provide the auditor with sufficient, appropriate audit evidence to support their reporting to the FCA and to those charged with governance" (paragraph 37 with similar amendments to paragraphs 53 and 95 (not presented)) ('Revision 1'), and
- "The CASS auditor should also provide assurance to the FCA that the CASS firm's own reporting of breaches that it has identified are a complete record" (paragraph 37 of the Contextual Material to the Client Asset Assurance Standard) ('Revision 2').

Any change in scope would require an increased level of assurance work to be performed and additional time taken to complete the engagement. In turn this would be likely to result in higher fees for CASS assurance engagements. We note that FCA received comments from CASS firms about higher fees in responses to the Feedback Statement & Impact Assessment. We question whether CASS firms would perceive the additional value in the proposed scope changes sufficient to warrant further fee increases. Please note that we have not sought to quantify the potential impact on assurance costs at this stage.

In addition to the impact on costs and fees, our specific concerns over these revisions of scope are as follows:

Revision 1

The proposed revision requires the CASS auditor to gather sufficient appropriate audit evidence to report to management and those charged with governance those issues which, in their judgement, 'pose the most significant risk of non-compliance with the CASS rules, and which require the most urgent resolution'.

We are supportive of the objective of strengthening the reporting requirements to those charged with governance including the prioritisation of the findings to be reported as set out in the impact assessment. However, we believe that reporting of findings should be limited to those arising from our work to support the CASS opinion and not the purpose of our work. In our view, the Assurance Standard should require the CASS auditors to perform sufficient work to support the CASS opinion given to the FCA. The CASS auditor should also consider whether any findings from the work performed to support the CASS opinion given to the FCA should be reported to management and those charged with governance. Any report to management or those charged with governance should utilise the findings of the work performed to support the CASS opinion given to the FCA only, as opposed to any additional work being performed specifically to inform the report to management or those charged with governance.

The CASS audit is a client asset assurance engagement that involves providing a Client Assets Report to the FCA. The scope of the Assurance Standard as set out in paragraphs 1 to 7 of the Assurance Standard makes reference to the requirements with respect to the process for forming, and the expression of, reasonable and limited assurance opinions. Neither the scope of the CASS audit, nor the scope of the Assurance Standard extends to separately gathering evidence to support the communication of such matters outlined in Revision 1.

The Assurance Standard already includes the requirement for the CASS auditor to communicate to management and those charged with governance deficiencies in internal control that, in the CASS auditor's professional judgement, are of sufficient importance to merit management's attention. This reflects the objective of ISA (UK) 265 "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" ('ISA (UK) 265') which states that:

"The objective of the auditor is to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor's professional judgement, are of sufficient importance to merit their respective attention."

We do not believe that it is appropriate for the requirements of the Assurance Standard to be more onerous or go beyond the scope of requirements for a financial statement audit and ISAs (UK).

There is also a risk that this expanded reporting requirement creates an expectation gap between the CASS auditor and management and those charged with governance of CASS firms. The CASS auditor is required to express an opinion on adequacy of systems throughout the period and compliance with the CASS rules at the period end, or that nothing has come to light indicating client money and/or assets have been held during the period. The work performed must be sufficient to support these opinions. The expansion in scope suggests further work on the control environment may need to be performed beyond that required to support the CASS opinion.

The primary responsibility for compliance with the CASS rules and for the identification of risks of non-compliance rests with the CASS firm, with support provided from their compliance team, CASS advisors and internal audit function as appropriate. The additional reporting requirement risks transferring this responsibility to the CASS auditor, and expanding the scope of the CASS auditor's work beyond that required to support the assurance opinion provided. This also risks CASS firms perceiving their CASS auditor as a potential source of support for the design of changes to internal controls as a result of the CASS auditor's findings. Any such support by the CASS auditor could potentially impair their independence.

Arguably, the information most relevant to management and those charged with governance are those risks which carry a risk of serious consequences, beyond a reported breach and modified CASS report. These might not be the risks in relation to the breaches that have been identified as most likely to occur. There is a possibility that the 'most significant risks' of non-compliance are in relation to 'technical' breaches of CASS rules that may not either pose a risk to client money or be of significant interest to the FCA. Reporting of these, instead of or with greater emphasis than less probable risks of a breach which could pose a significant risk to client money or be of material interest to the FCA, does not seem appropriate to the needs of management and those charged with governance or in line with the objectives of the Assurance Standard. We request that the FRC clarify that 'significant' is intended to be interpreted as having the most serious consequences rather than as 'most probable'.

The FRC's response to point iv in the 'Analysis of Call for Feedback and detail of proposed revisions to the standard' makes it very clear that there is no concept of materiality for breaches. As such, we feel that to be consistent the CASS auditor should report all risks of non-compliance, together with all breaches, identified during the course of the work to support the CASS report. We would encourage greatest emphasis to be placed on the most significant of these risks and breaches.

We request that paragraph 135 of the draft Assurance Standard is amended to make it clear that only those deficiencies in internal controls identified in the course of the work to support the CASS report are within the scope of the reporting responsibilities of the same paragraph, and that the FRC consider consistency with the objective of ISA (UK) 265 when drafting any revisions to this paragraph. We also request that the FRC removes 'pose the most significant risk of non-compliance with the CASS rules and which' from the same paragraph, and that 'and to those charged with governance' is removed from the proposed amendments to paragraph 95.

Revision 2

The proposed revisions to paragraph 37 (previously paragraph 43) of the Contextual Material to the Client Asset Assurance Standard require the CASS auditor to 'provide assurance to the FCA that the CASS firm's own reporting of breaches that it has identified are a complete record'.

We believe that the current wording of the revision does not clearly set out the objective of the amendment. The revision could either be interpreted as requiring the CASS auditor to:

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- a) Report to the FCA whether the breaches reported to the FCA by the firm are complete; or
- b) Report whether the breaches recorded by the firm in their own breaches register are all the breaches the firm has identified.

We set out below our concerns about either interpretation.

If the objective is to report to the FCA that the breaches reported by the CASS firm to the FCA are complete, then this does not seem to change the requirements that already exist. Principle 11 requires a firm to deal with its regulators in an open and cooperative way and to disclose to the FCA appropriately anything relating to the firm of which the FCA would reasonably expect notice. The matters reported are highly unlikely to be a complete record of all breaches identified as firms will record breaches that are not of such significance as to require these to be reported to the FCA. Such breaches will however, be recorded in the Breaches schedule appended by the CASS Auditor to its report to the FCA under the current requirements of both the FCA rules and the Assurance Standard. Where the CASS auditor identifies a matter of material significance to the FCA the requirements of The Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2011 impose an obligation on the auditor to make a report to the FCA as soon as practicable. This could include significant breaches that the firm has identified and recorded but not reported to the FCA in accordance with Principle 11 and SUP 15.

If the intention of the amendment is to report to the FCA about the completeness of breaches identified by the firm, then the Assurance Standard currently requires the CASS auditor to set out those breaches of CASS by the firm *of which they are aware*. It goes on to state that the sources of those breaches include 'those breaches identified by the firm (such as those included in the firm's breaches register)'. The requirement to confirm the completeness of the firm's own record of breaches expands this requirement. We do not believe that it is possible to obtain sufficient and appropriate evidence to allow the CASS auditor to form an opinion as to whether the CASS firm has recorded in its breaches register all the breaches it has identified.

The proposed amendments to the Assurance Standard do not expand on the work expected to be performed by the CASS auditor to support this further assurance opinion, beyond the written representation, discussions with management and review of the firm's breaches register already required by the Assurance Standard. As such, we are unclear how the FRC envisages that the CASS auditor would obtain sufficient and appropriate evidence to support the proposed opinion.

We also note that there have been no changes to the illustrative opinions (other than inclusion of CASS 11) in the proposed amendments to the Assurance Standard. As such, it is unclear how this additional assurance would be provided to the FCA. Other than the direct reporting responsibilities mentioned above we are not aware that the FCA places any obligation on CASS auditors in relation to reporting on breaches beyond the requirement to include all identified breaches on the Schedule of Breaches appended to a modified CASS Report, regardless of whether identified by the firm, the CASS Auditor or another party, such as the FCA. We do not believe the FRC should be seeking to extend those obligations.

We request that the proposed insertion of 'The CASS auditor should also provide assurance to the FCA that the CASS firms own reporting of breaches that it has identified are a complete record' in paragraph 37 of the Contextual Material to the Client Asset Assurance Standard is removed.

2. Engagement Quality Control Review

In our opinion the Engagement Quality Control Requirement ('EQCR') should be mandatory for all reasonable assurance reports. Therefore, we have concerns about the proposed 'two-tier' approach to mandatory EQCR. We do not believe that the different requirements for Medium and Large CASS firms and Small CASS firms are proportionate to the potential risks arising in each category of CASS firm for the following reasons:

1. We consider that Small CASS firms may be more likely to be dealing with retail clients as opposed to commercial or professional clients. As a result, the impact of a loss of client money on Small CASS firms' customers could arguably be proportionately greater than for the customer base of at least some Medium or Large CASS firms. Given the less sophisticated nature of retail clients, it is also unlikely that they will be aware that the Small CASS firm is subject to fewer CASS audit

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- requirements than a Medium or Large CASS firm, and therefore this would not factor into their risk assessment when placing money with a Small CASS firm.
2. Start up firms are also likely to initially be classified as Small CASS firms. The start up may grow quickly and soon be classified as a Medium CASS firm. In the same way that the CASS firm should embed appropriate governance structures and compliance monitoring early, we believe that the CASS auditor should have the same requirements irrespective of the stage of the CASS entity's life cycle. This would also help prevent issues only being identified when a CASS firm becomes classified as a Medium CASS firm.
 3. Small CASS firms may be more likely to use smaller CASS auditors who in turn may be more likely to have less experience completing CASS assurance engagements. Less experience means that CASS auditors may not necessarily identify all the risks to client money or breaches of CASS rules. This increases the detection risk inherent in such engagements, a risk which a mandatory EQCR could help mitigate.
 4. In our experience Small CASS firms often have less sophisticated systems and controls to address CASS risks. They also often do not have the same level of compliance support as larger firms, such as internal audit or in-house compliance functions or extensive external compliance advisor time. In such cases the increased control risk, coupled with the potential increased detection risk outlined in point 3, again suggests that a mandatory EQCR would be proportionate to the CASS assurance engagement risk.
 5. Firms may fluctuate between CASS category but their systems, procedures and risks to their clients would not necessarily change as a result and nor should the rigour of the requirements applied to their CASS Auditor.
 6. For the same reasons outlined above, we do not believe that it is appropriate to classify a nonclassified business in accordance with the requirements of CASS 1A2.7R to determine the requirement for a mandatory EQCR.

We request that the FRC remove the amendment to paragraph 137 of the draft Assurance Standard (previously paragraph 141), as well as the resulting amendment to paragraph 139 (previously paragraph 143).

If this request is not accepted, then we would ask that the FRC consider requiring CASS audit firms to adopt a firmwide policy for EQCRs for Small CASS and non-classified CASS firm assurance engagements, as opposed to the need for an EQCR being determined on a case by case basis. We believe that this would enhance the consistency of the quality of the CASS assurance report and ensure consistency of the need for EQCRs within the firm for similar CASS engagements.

3. Definition of 'insolvency mindset'

Whilst we welcome the definition of 'insolvency mindset' being included in the main body of the Assurance Standard, rather than in the Contextual Material, we believe that the amendment to what an insolvency mindset requires would be more useful to the CASS auditor if it made reference to segregation as well as the adequate maintenance of records. We consider that the appropriate segregation of assets is equally important to the adequate maintenance of records in the event of insolvency and believe that it would be appropriate for the Assurance Standard to refer to both objectives.

We request that the amendment to paragraph 41 of the draft Assurance Standard is amended to:

"An insolvency mindset in the context of CASS engagements requires the auditor to ensure that client assets are segregated from those of the regulated entity and that the records maintained by a regulated entity are adequate to identify client assets at any time and without delay to allow their return to the legal owner (CASS 6.6.2 and 7.15.2)."

4. Consistency and other comments on the draft Assurance Standard

Please note that the following paragraph references are to the amended paragraph numbers in the draft Assurance Standard.

Paragraph 14: To ensure consistency with the amendments to paragraph 14, 16 and 17 we recommend that the draft wording is amended as follows:

Where the scope of the firm's permissions includes the holding of client assets and the firm claims that it holds or controls client assets, the CASS auditor shall provide a reasonable assurance Client Assets Report including a breaches schedule as required by the FCA's Rules. In such cases the CASS auditor shall comply with all the requirements of this Standard set out in paragraphs 11 to 141 and in the case of non-statutory client money trusts also paragraphs 172 to 177. However, the FCA's Rules do not require a reasonable assurance Client Assets Report in relation to certain firms in certain circumstances's.

Paragraph 23: To ensure that the Assurance Standard is 'future-proofed' insofar as is possible, we would ask that the FRC considers any divergence between the new FRC Ethical Standard and the IESBA Code. If it is anticipated that the revised FRC Ethical Standard could be more restrictive than the IESBA Code, then we would ask that the FRC consider amending the wording of paragraph 23 at this opportunity to avoid confusion and/or further revisions in the near future.

Paragraphs 37, 53 and 95: The modifications to these paragraphs make reference to 'audit evidence'. We note that the CASS assurance engagement is not an ISA engagement, and as such we ask that the terminology is consistent with that for an assurance engagement under ISAE 3000. We recommend the following amendment to the proposed wording for paragraph 37:

The CASS auditor shall exercise professional judgment in planning and performing an assurance engagement, including when determining the nature, timing and extent of procedures to be performed. The procedures to be performed shall be sufficient to address the engagement risk, and to provide the auditor with sufficient, appropriate audit evidence to support their reporting to the -PGA and-to those charged with governance the CASS opinions.

Similarly, we ask that 'sufficient appropriate audit evidence in support of the auditor's reports to the FCA and those charged with governance' in paragraph 53 and 'sufficient, appropriate audit evidence to support the required reporting to the FCA and to those charged with governance' in paragraph 95 are replaced with 'sufficient, appropriate evidence to support the CASS opinions'.

Paragraph 108: The modification to this paragraph makes reference to the 'audit file'. As in the above point, we ask that this be changed to refer the 'CASS assurance file' or equivalent wording.

Paragraph 115: As previously noted, we welcome the FRC's efforts to reduce duplication from the Assurance Standard. We are concerned that the proposed addition to paragraph 115 adds unnecessary duplication of the requirement already included in paragraph 121 and supplemented by the implementation guidance in paragraphs 122 to 125. If the FRC do not believe this is duplication, it would be useful to expand the point to ensure that the additional requirement is clear.

Appendix 4: We note that Appendix 4 has been updated to include reference to CASS 11. We request that it is also updated to include reference to CASS 13, given the proposed inclusion of CASS 13 in the Contextual Material to the Client Asset Assurance Standard.

Consistence with ISAE 3000 and ordering: As we explained in our consultation response to the original exposure draft and our response to the Call for Feedback, we believe the Standard would benefit from being more logically organised and more aligned with International Standard on Assurance Engagements ISAE 3000. We would ask the FRC take the opportunity presented by the revised version to consider the ordering as well as the consistency with ISAE 3000 in respect of our comments raised above in the context of paragraphs 37, 53 and 95, and more generally throughout the Assurance Standard.

5. Inspection and monitoring of CASS audits

We support the FRC's proposed approach of working with the FCA to pilot a small number of CASS audit inspections as part of a feasibility study. We would encourage any such pilots to consider how engagements would be selected for review as well as the appropriate scope of the review. We also

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ask that the FRC considers how the reports resulting from any such CASS audit inspections would be utilised, including whether they would be made publicly available.