



UK Finance response to the consultation on the proposed revisions to the Client Assets Assurance Standard

UK Finance would like to once again acknowledge the FRC's ongoing work to develop the Client Assets Assurance Standard (referred to as the "guidelines" in this response). It is a highly valuable piece of work which can bring significant benefits including improving the quality of audits, delivering consistency in market practice, and provide further guidance for firms' compliance frameworks. We support the introduction of an industry-led forum to further support consistent market practice and the delivery of high quality audits.

UK Finance has included in this response an appendix which provides feedback and recommendations on the draft guidelines. Please note the comments are raised in the order they appear in the guidelines, rather than that of priority.

We would be pleased to have the opportunity to discuss our recommendations with the FRC in due course.

Rob Driver

Appendix

1. Credit Risk Definition (Introduction)

We recommend that the words “on a debt” are deleted so that credit risk articulates all failures to pay rather than only defaults on a debt e.g. delivery obligations under a typical currency swap involving exchanges of principal currency.

2. Scope (Para. 7)

The statement of scope should specify what “other rules relevant to the holding of client assets” fall within scope. Of particular significance is that functions subject to internal controls and/or audits where specialists are better placed to evaluate controls should not be subject to audit requirements e.g. IT resiliency.

3. Business model and the permissions received from the FCA (Para. 11)

The statement should make it clear that with regards to third parties, third parties holding client money bank accounts for a given firm and qualifying money market funds are also important third parties.

4. Feedback Statement and Impact Assessment (para. 13)

We note the FRC’s view that, given no change to audit scope is proposed, the cost impact of any changes should be limited to a one-off Auditor training cost of two hours per audit. As we have noted in our comments above on para. 37 and para. 70, drafting in places could increase the burden placed on both auditors and firms, with a corresponding increase of costs.

As any increase in costs is borne by industry, it is important that the drafting is clear and avoids unintended increase in audit scope.

5. Identification of breaches (Para. 37 and Para. 115)

Para. 37 states that “*the FCA requires all breaches identified by both the CASS auditor and disclosed to it by the firm to be reported to it by the CASS auditor. 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*”. However, para. 115 says “*the CASS auditor is required to report all breaches identified by it or identified to it by any other party including the firm*”. These two statements appear to conflict as para. 37 only requires auditor identified breaches to be reported, whereas para. 115 requires all breaches to be reported to the FCA. It is our understanding that the FCA expects all breaches, regardless of identifying party, to be reported to them, but welcome clarification on this conflict.

In addition, it is unclear how the auditor would be able to provide assurance that the firm’s breach log is a complete record without additional testing, and therefore an increase in the burden placed on both auditors and firms. We believe the standard should clarify that no additional testing should be required to meet this requirement, or the amendment to para. 37 should be removed.

6. CASS auditor's right to report to the FCA (paras. 62 – 64)

The reporting obligation does not currently require the auditor to disclose to the firm that it has reported a material matter to the FCA. Although there may be some instances where this is inappropriate (e.g. where tipping off is a criminal offence) the firm should be advised of the conversation.

7. Professional Judgement of Engagement Risk (para.70)

The guidelines allow to some extent the CASS Auditor to consider the main areas of engagement risk and then use their discretion to deploy resources accordingly. These changes appear to have been made to address the feedback relating to 'over auditing', the lack of proportionality being applied in CASS audits, and audit firms failing to base their work on the key areas of identified CASS risk.

The key relevant updates to standard are as follows:

- (i) The introduction of a requirement for CASS auditors to document the main areas of engagement risk and how resource will be deployed to assess the firm's management of this risk;
- (ii) Update to confirm that the CASS auditor can apply judgement when selecting items for testing; and
- (iii) Removal of the section relating to the concept of materiality in the context of a CASS audit (Contextual Material to the Client Asset Assurance Standard - Planning and performing the CASS audit – 39).

It is however made clear in the *feedback statement & impact assessment* that the FRC acknowledges that there is no concept of materiality in CASS, and that the CASS auditor must still ensure that they provide a reasonable assurance opinion on the firm's overall compliance with CASS. As defined in the standard, this requires the CASS auditor to provide "a *high but not absolute level of assurance*".

Considering the changes to the standard and the lack of guidance to support those changes, it is unlikely that auditors will be able to use their discretion without exposing themselves to the risk of being accused of failing to provide reasonable assurance in the event that an issue arose that they did not foresee.

Essentially, the updates allow auditors to use their discretion, but does not appear to provide them any insight into what the consequences would be in the event that an informed, risk-based decision, they made was in hindsight found to be the wrong one. Without this, it appears unlikely that these changes will result in any change in auditor approach and so will not address the points of feedback noted above.

8. Consideration of IT risk (para.70)

One of the consequences of the updated CASS standard when it was published in 2015 was an auditor focus on the management on Information Technology (IT) risk as part of the CASS audit. As this has been further emphasised in the updated standard, this will likely be an area that CASS auditors continue to expand.

It is acknowledged that if an IT risk was to crystallise it could affect a firm's ability to comply with CASS. However, the purpose of CASS is not to set out how regulated firms should manage IT risk. To support the CASS audit, firms must ensure that they can evidence how the systems in place have been designed and operate in compliance with CASS (and only CASS). This focus on the management of IT risk as part of the CASS audit has unintentionally resulted in the CASS audit scope increasing. CASS auditors are now undertaking an assessment of the firm's management of IT risk against the requirements detailed in other FCA sourcebooks.

Though regulated firms are clearly required to be able to evidence how they meet all FCA requirements, compliance with non-CASS regulations should not be assessed as part of a reasonable assurance CASS audit. We acknowledge that the FRC have noted their reluctance to provide guidance, but by the FRC's inclusion as a requirement the need to consider the management of IT risk, without the required guidance to support the CASS auditors understanding of how this should impact the scope of their work, the result is a lack of clarity and over-auditing.

9. Consideration of previous CASS audit findings and recommendations (para.72)

We recommend that auditors are compelled to consider previous CASS audit findings and recommendations (para. 72 of the Guidelines provides no obligation to do so).

10. Control environment (para. 81)

We recommend that the FCA should consider whether an evaluation of "*effectiveness*" is more appropriate than an evaluation of "*strengths*" of the control environment, and whether the policy and procedures support the conclusion (and in turn enable the CASS auditor to form an opinion) that the control environment regime actually works. We are concerned that an evaluation of "*strengths*" in this context potentially points to a "*tick box*" exercise, rather than a substantive opinion.

11. Third Party Administrators ("TPAs") (paras.106–109)

It is likely that the TPAs are also subject to a CASS audit requirement. If this is the case, we believe the guidelines should be clear that there is no obligation on the firm's CASS auditor to investigate its TPA CASS audit (as this would result in an unhelpful duplication). The guidance appears to treat TPAs subject to their own statutory CASS audit and those with no statutory CASS audit in the same manner. We are under the assumption that the text is based on a TPA which has not been subject to a CASS audit. We recommend considering that the guidelines include the distinctions that should be drawn where a TPA is regulated, as opposed to when it is not (e.g. Financial Market Infrastructures holding client cash and assets as collateral).

12. Legal guidance (para. 112)

We recommend the guidance notes that the CASS auditor should act with legal guidance where necessary (the text reads as though an independent and unassisted interpretation of contractual matters is required of the auditor, who will not be legally qualified in most cases).

13. Breach Record Integrity (para.116)

The guidelines places a requirement on the CASS auditor to *'provide assurance to the FCA that the CASS firms own reporting of breaches that it has identified are a complete record'*. However, it is unclear what the FRC's expectations are on CASS auditors in order to achieve this, and without further details, it could lead to divergent approaches.

We believe that if the CASS auditor carried out their audit in-line with the standard, they would identify areas of control weakness and/or non-compliance, which would be reported to the FCA. If the FRC agree, then the addition of this requirement provides no additional value, and creates the risk of CASS auditors misinterpreting the requirement, and we recommend removing the requirement. If the FRC does not agree with our view, we ask the FRC to reconsider the drafting to ensure it does not require further interpretation.

14. CASS audit monitoring regime (para.116)

We are supportive of the introduction of an FRC audit inspection and monitoring approach, and acknowledge that the FRC has committed to discussing the approach with the FCA. We recommend the following issues are considered in these discussions:

- (i) How the costs of this regime will be met;
- (ii) What the consequences on the regulated firm will be in the event that a CASS auditor failed to perform an audit in line with the standard. We propose that the CASS auditor would be required to consider the feedback received and reflect this in their audit work for the current audit period (we would not be supportive of the auditor 're-opening' a previous CASS audit);
- (iii) In the event that a CASS auditor opinion was not accepted e.g. the report should have been "adverse" rather than "qualified", how that difference of opinion would be managed. We would not be supporting of the auditor 're-opening' an audit to satisfy a finding under the monitoring regime;
- (iv) There should be consideration as to whether the findings from this monitoring regime should be made public, or at least available to those firms whose audits have been reviewed.