



## POST IMPLEMENTATION REVIEW PROVIDING ASSURANCE ON CLIENT ASSETS TO THE FCA - CALL FOR FEEDBACK

Issued 1 March 2019

ICAEW welcomes the opportunity to comment on the Post Implementation Review Providing Assurance on Client Assets to the FCA – Call for Feedback published by Financial Reporting Council on 6 December 2018, a copy of which is available from this [link](#).

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## ANSWERS TO SPECIFIC FEEDBACK QUESTIONS

**Question i. Do you agree that the CASS Standard has been successful in delivering the objectives set out in Paragraph 9 of the Introduction to the Standard and replicated in the covering paper? Please explain your reasoning.**

1. The standard has had a positive impact on meeting the stated objectives. Awareness of how the standard supports the objectives of the FRC and FCA has increased. Auditors and regulated firms have invested in training, people and systems following its introduction. More senior management time is spent on review, and there is greater specialism.
2. However, while auditors and regulated firms have engaged with the standard, it can be challenging to get the requisite level of engagement from outsource providers, which are a vital part of the CASS landscape. There is also additional work to do to ensure that regulated firms understand the level of effort required of the CASS auditor.
3. Despite an overall increase in quality, we understand the FCA believes there is variability in the quality of CASS assurance engagements. Divergent approaches (ie, in relation to the extent of detailed testing) can result where there is limited detailed guidance from the FRC.
4. One of the biggest challenges facing firms is consistent interpretation of the rules. Additional detailed guidance from the FCA would support consistent interpretation of requirements and a more standardised approach, which would aid in the standard meeting its stated objectives. This issue warrants further attention.
5. Some of the objectives of the standard may not in fact be met by CASS audit work alone. As with any assurance opinion, there are inherent limitations to a CASS audit report, which is a private opinion to the FCA. It is one part of the suite of tools used to supervise CASS firms.

**Question ii. Do you agree that the enhanced independence requirements of the FRC Ethical Standard have been positive in underpinning user confidence in CASS audit? Please explain your reasoning.**

6. The level of independence required has restricted choice for clients who wish to tender their CASS audit outside of the statutory auditor. A number of CASS auditors have a rebuttable presumption that they will not accept CASS audits without also being appointed as the statutory auditor. This is not necessarily congruent with the independence standard required for other private assurance engagements to the FCA, for example work performed under the s166 regime.
7. Further clarity is needed on the application of the rotation rules to CASS audit, as different approaches are being adopted.

**Question iii. Do you believe that the quality of CASS audits has improved? If so what are the indicators of this?**

8. The improvement in the quality of CASS audit has been inferred from the FCA's comments on improved quality at conferences. Feedback from CASS auditors is that more robust and challenging audits are being conducted, and our members anecdotally report an increase in identified and reported breaches, as well as an increase in adverse and qualified opinions.

**Question iv. Are there further steps that the FRC should consider including in the CASS Standard, to support the delivery of consistently high-quality CASS audits? Please set these out in your response.**

9. While there is more the FRC could consider including in the standard, it is important to emphasise the difference between a CASS audit and a statutory audit.
10. Although the FRC standard was more prescriptive than the previous bulletin, it lacks the detail of the framework provided by the ISAs, therefore implementation of the requirements is more variable. This makes it difficult to monitor firms against consistent criteria.
11. More guidance could be considered in the following areas:

## Proportionality

12. The control approach appears to prescribe a rigid approach to controls testing. This should be flexed based on the differing levels and sizes of firms who are subject to a CASS audit, and the related governance these firms operate under. Smaller firms may not have formalised evidence of every control in the way larger firms do but where their governance, oversight, control environment and monitoring are appropriate to their activity.

## IT systems and controls

13. There is a lack of clarity in the standard to how CASS auditors should evaluate IT systems and controls, and their impact on the audit approach. A number of regulated firms do not identify and map IT controls in their risk and control mapping document.

## Materiality

14. With no concept of materiality, it is unclear how much work the CASS auditor must conduct. This results in the CASS auditor reporting errors in the pennies. The use of materiality should be considered, or whether a risk-based approach, with greater use of professional judgement, would be more appropriate. The requirement to report every breach often results in an extensive breaches schedule and audit procedures undertaken. This means auditors spend a lot of time working on breaches when an alternative mechanism would be for the firm to submit the breaches log directly to the FCA. The FRC should consult with the FCA on a better way of obtaining the breaches log. Time should instead be spent working on the issues that cause the highest risk.

## Risk assessment

15. The Standard describes the need for auditors to consider the firm's risk assessment in relation to each relevant CASS rule. However there is variation in how regulated firms consider rules (and guidance) under the same risk, one firm could interpret a rule in a different way to another, and therefore the risk assessment will vary.

***Question v. The standard requires the auditor to assess an entity's compliance with the FCA's CASS Rulebook. Are there any specific additional areas of guidance that should be developed to help in the assessment of whether custody relationships are fully compliant with the CASS Rulebook?***

16. Other than noted in other responses we are not aware of any request for additional guidance in relation to custody relationships.

***Question vi. Bearing in mind that a primary objective of the standard is to support the delivery of the FCA's objectives for the CASS regime, including the safeguarding of assets held, and preventing failure of the regime, would you propose any changes to the current standard, and if so what would those changes be and why?***

17. Management have primary responsibility for safeguarding assets held. The FCA sets and supervises the CASS framework. The CASS audit is one part of the FCA's toolkit for CASS supervision alongside direct supervision, supervisory visits, thematic reviews, analysis of management breach reports and monthly CMAR reporting.
18. Assurance reporting alone does not prevent failure, and should not be the sole tool used by the FCA for prevention.
19. In particular, the extent that the FCA makes an assessment of CASS audit reports and links this to other regulatory information available to them in their supervision of CASS is unclear to us, given the limited direct feedback that CASS auditors receive in respect of individual CASS audits.

20. As a result, we are not proposing any changes other than the areas referenced in relation to other questions.

**Question vii. Do you believe that there would be benefits from bringing CASS audits within the FRC's audit inspection and monitoring approach? How do you believe any such monitoring scheme should operate?**

#### Cost

21. It is unclear how this would be brought into being without an increase in cost. The implementation of an inspection regime for CASS audits would be a significant cost that will need to be borne across all CASS audits in scope, therefore an increase in fees would be inevitable.

#### Resource

22. It is unclear whether the FRC have the immediate resources to bring CASS audits under the regime, as this would require a large investment and would be a significant ongoing project as there is no public body of guidance to use for CASS audits, unlike statutory audits. There are currently approximately 3,500 CASS audits completed per year by over 200 audit firms, which means it would be an extremely complex and burdensome logistical exercise to bring these under the regime. The audit inspection regime for the FTSE 350 is complex, trying to replicate this for ten times the number of CASS audits would be extremely challenging.

#### Inspection

23. The effectiveness of CASS assignments is more transparent to the FCA as the recipient of the CASS audit report than financial statement audits due to the complete nature of breach reporting (via the breaches appendix) and via CASS reviews and interventions made by the FCA. The FCA, as the user of CASS opinions, will have (via their interactions) a view on the effectiveness of the CASS assurance engagement at large and a number of medium CASS firms. If, like the AQR regime, the inspections focus on the largest companies and the largest firms, it is likely that the FRC will be covering the same ground as the FCA rather than focusing on CASS assurance engagements and firms that are more distant from the regulator's focus and where the risk is arguably higher.
24. In addition, the FCA have the means to speak to firms and their auditors, where they have concerns, existing mechanisms allow the FCA as the user to report these concerns to the FRC to inspect further.

**Question viii. Would you suggest any changes to the standard to increase the value of CASS audit to those entities that are subject to the regime? If so what changes would you propose and why?**

#### Reliance on the work of others

25. The FRC should consider allowing CASS auditors to rely on work performed by the regulated firm's internal audit, independent compliance function or service auditor to increase efficiency in CASS audits. As the standard is currently drafted, there is uncertainty on the circumstances for the use of such work, and the degree of reliance a CASS auditor may place on such work.

**Question ix. Are there any other matters that the FRC should take account of in carrying out this post implementation review? If there are, please set them out in your response.**

## CASS 8

26. Guidance needs to be created in respect of the responsibility to report over CASS 8: Mandates. Furthermore, under limited assurance engagements, if guidance is followed, the CASS auditor will contradict SUP as there appears to be a drafting error here, which leads to confusion for the CASS auditor.<sup>1</sup>

## Reporting control failures

27. Additional clarity is needed on reporting mechanisms for control failure which do not constitute a breach of the FCA rules. Current practice will see some points reported via management letter, and some points escalated under the auditor's duty to report to the regulator. Guidance will help auditors identify how control deficiencies which do not breach the rules, but represent a sufficiently serious breakdown in the overall control environment, should be reported.
28. Formalising the requirement to report on matters which are entity wide and/or thematic using principles drawn from ISA 260 *Communication with Those Charged with Governance* could enhance the regime. These could include significant findings from the CASS audit such as:
- The auditor's views about significant qualitative aspects of the entity's CASS practices, including policies and FCA reporting approaches.
  - When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant judgemental area is acceptable under the applicable CASS rules.
  - Significant difficulties, if any, encountered during the audit.
  - Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management.
  - Written representations the auditor is requesting.
  - Other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the CASS process.
29. The FCA may also be interested in these matters.

## Form of opinion

30. Given the nature of CASS audit work, qualified opinions are anticipated under a reasonable assurance approach. Considerable scepticism is applied when a clean opinion is issued. The FRC should consider whether a different form of audit report would be appropriate for the FCA (as the sole user of the reports). At its core, a CASS audit is an opinion on systems and controls, therefore a more useful form of opinion maybe based on an ISAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* format.

## Oversight

31. The CASS auditor is required to perform an evaluation and assessment of the objectivity of the oversight approach and quality control. The Standard should articulate the criteria against which this assessment is made.

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<sup>1</sup> FRC Assurance Standard, para 14