

27 February 2019

Mark Babington,
Financial Reporting Council,
8th Floor,
125 London Wall,
EC2Y 5AS.

By email only to: AAT@frc.org.uk

Dear Mr Babington,

Post Implementation Review – Providing Assurance on Client Assets to the Financial Review

We are pleased to respond to your call for evidence as part of your post implementation review.

We agree with the FRC that the November 2015 CASS Standard has had a positive impact on the quality of work undertaken by CASS auditors of all sizes. We have set out our responses to the feedback questions in the attached, bearing in mind the FRC's overriding objective (which we share) of supporting the FCA's objectives for the CASS regime in the UK.

If you would like to discuss any of our responses in more detail, please do not hesitate to contact me.

Yours sincerely

Michael Williams
Partner, Deloitte LLP

Appendix – Responses to feedback questions in the call for evidence

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.

Yes.

We have identified a small number of areas in our responses to question iv below where we believe additional clarity and guidance would be helpful to provide more support and challenge to CASS auditors.

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.

Yes.

We believe that the appropriate degree of harmonisation with the FRC Ethical Standard has been helpful, if only in addressing the perceived issue of CASS auditors applying the relevant professional body's code of ethics – it is now clear that the ethical requirements are set by an independent standard-setter after due process. We welcome, in particular, the requirement for the 'Third Party Test' in paragraph I14 which requires the CASS auditor to consider the perspective of an objective, reasonable and informed third party.

We have only one suggestion for potential change in the independence requirements applicable to CASS auditors. The standard applies certain additional requirements to "public interest entities" (PIEs) – which is a term derived from the Statutory Audit Directive. It is possible that there is an entity holding little client money and assets which is, nevertheless, part of a group containing a PIE – the PIE requirements would apply to this entity; conversely, an entity holding large amounts of client money and assets in a complex environment not be in such a group and therefore not subject to the PIE requirements. It may be worth considering whether an alternative way of setting the public interest for CASS engagements is appropriate – for example, the FCA's own designation as a CASS Large firm under CASS 1A. This would more closely align the degree of public interest in the firm's handling of client money and assets with the potential impact on the public of their failure to do so.

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

Yes.

We have always committed to consistently providing the highest quality CASS audits and seek continuous improvement to our CASS audit methodology and processes. At a high level, Deloitte CASS audit work programmes and methodologies were already in place when we were operating under the FRC's Bulletin 2011/2 and Practice Note 21 guidance. We updated our CASS audit tools and methodologies to introduce additional requirements set out in the CASS Standard in order to support engagement teams deliver high quality CASS audits. These are summarised below:

- a) Enhanced mandatory CASS training programmes which all members of CASS assurance engagement teams are required to complete. The breadth of coverage of the training materials has increased, principally to cover the new requirements placed on the CASS auditor by the CASS Standard.
- b) Further standardisation of our CASS audit methodology and work programmes to deliver CASS audit work.
- c) All CASS audit engagements (whether reasonable or limited assurance) carried out by our firm have always been subject to independent Engagement Quality Control Review (EQCR) by our team of CASS technical specialists for both reasonable and limited assurance engagements. In response to the standard, we formalised a requirement that the EQCR of higher risk engagements must be led by an appropriately trained and experienced partner.

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.

Yes.

Whilst the CASS Standard has been a helpful aid to CASS auditors, we have identified certain areas which would benefit from further guidance to support the consistent delivery of high quality CASS assurance engagements across the audit profession.

- a) *Information Systems used in CASS control environment* – We have observed that CASS firms of all sizes are increasingly reliant on IT systems, automated controls and calculations and system generated reports to meet their obligations under the CASS rules.

The CASS Standard includes guidance in paragraph 55 of the Contextual Material asking the CASS engagement leader to consider the use of IT specialists as part of the audit of larger and more complex regulated firms. We would welcome further guidance in developing appropriate audit procedures which address the risks associated with automation and reliance on IT systems to ensure CASS auditors adopt a consistent and proportionate response for all sizes of CASS firms.

- b) *Shared service centres* – There are situations in which processes and related controls are centralised by a group within a shared service centre. In such circumstances, subject to engagement leader judgement, we believe there is an opportunity to increase efficiency of the audit process whilst maintaining audit quality.

We would welcome further guidance on the acceptability of the CASS auditor adopting a common controls approach when the engagement leader is satisfied that the processes and controls performed for each firms are, in practice and nature, performed identically and all sit under the same governance structures. A common controls approach would allow the CASS auditor to treat a population of controls performed by the shared service centre on behalf of all firms as a single population for sampling, and use the results of such testing to detect patterns of control weakness or exception across the entire population. In practice, this would allow the CASS auditor to use the results of sample testing of the single centralised population to provide audit evidence about the control environment of each of the discrete firms using the shared service centre.

- c) *Third party administrators* – The CASS Standard already contains material relating to third party administrators (TPAs) in paragraphs 103-113. We believe it would be helpful for the CASS Standard to include material relating to the use of a service auditors' report in such circumstances, akin to the way in which a financial statement auditor applies ISA (UK) 402. This may be of increasing relevance as firms move their IT environment into the cloud; it may simply not be practical for the CASS auditor to directly perform tests of controls at the cloud provider whereas a report under ISAE 3402, ISAE 3000, SOC 1, etc. may be available.

- d) *Engagement quality control review* - The CASS Standard contains no detailed guidance in respect of the EQCR of a CASS limited assurance engagement, potentially on the grounds that under ISQC (UK) 1, firms need policies and procedures as to whether such reviews are required, and it is possible that some firms may have determined that limited assurance engagements are lower risk and therefore should not have such a review. Whilst this is a matter of judgement for the firm concerned, it does mean that the CASS Standard is silent on what would be needed if the firm determined such a review was required – for example in a situation where the firm is considering modifying its opinion.

We suggest that the FRC considers moving the EQCR material in to a separate section, applicable to both reasonable and limited assurance engagements, with an introductory paragraph indicating that these requirements apply to all reasonable assurance engagements and to those limited assurance

engagements where the firm has determined an EQCR review is required. This could, perhaps, be done as part of changes to respond to the IAASB's proposed replacement of ISQC 1 by ISQM 1 and ISQM 2.

- e) *Claims management firms* - The CASS Standard needs to be updated to reflect the new requirements of CASS 13 resulting from the FCA taking on the regulation of claims management companies set up or serving customers in England, Wales and Scotland.
- f) *Benchmarking strategy for control testing* - It would be helpful if the CASS Standard included requirements and guidance on the testing of automated application controls which form part of the CASS controls where these have not changed year on year. For example, under AS2201 of the PCAOB, if general IT controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor verifies that an automated application control has not changed since the auditor established a baseline (i.e., last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year's specific tests of the operation of the automated application control. This is known as a "benchmarking strategy". The nature and extent of the evidence that the auditor should obtain to verify that the control has not changed may vary depending on the circumstances, including depending on the strength of the company's program change controls.

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?

No.

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?

Yes. See our suggestions in response to question iv above.

We have one additional area which needs to be addressed. There is a requirement in CASS 5.4.4 for a firm using a non-statutory trust to obtain and keep current written confirmation from its auditor that it has in place systems and controls which are adequate to ensure that the firm is able to monitor and manage its client money transactions and any credit risk arising from the operation of the non-statutory trust arrangement (the "letter").

The CASS Standard included the first material for CASS auditors in this situation, with requirements and guidance in paragraphs 176 – 181 and an illustrative example of a confirmation letter in appendix 11. Whilst we welcome this guidance, we have identified a number of challenges in preparing the letter which could be addressed by amending the CASS Standard. The challenges and our proposed changes are set out below.

- *The nature of the confirmation* - The confirmation statement in the letter is a statement of fact, contrasting with, for example, a reasonable assurance opinion. Whilst the CASS Standard describes factors that should be considered in preparing the letter, it is not clear what level of work is required to provide such a confirmation, whether it is appropriate to rely on work performed in preparing a reasonable assurance opinion or whether a confirmation can be provided as a standalone document. We are concerned that the current form of the letter infers a greater level of assurance to the FCA and to firms than it may actually represent. It differs from the approach taken in other professional literature when an auditor is asked to report on the effectiveness of the design of controls, for example, ISAE 3402 and the PCAOB's standards on internal control over financial reporting – in particular, it asks for the firm to confirm that systems and controls are adequate to "ensure" something, implying absolute insurance.

- *Applicable time period* - The letter is not restricted to a period or a reference date but refers to firms 'having and maintaining' adequate systems. This infers that the letter can be relied upon beyond the date up to which the auditor has tested and that the letter might be relied upon by the firm or the FCA inappropriately.
- *Frequency of issue* - The CASS Standard does not provide guidance over the frequency with which the letter should be issued by the CASS auditor or the scenarios in which it should be re-issued. This could lead to variation of practice and uncertainty as to the level of reliance that the firm or the FCA can place on the letter.
- *Impact of breaches or controls failures* - The CASS standard does not include any guidance over the treatment of breaches reported in the client assets audit opinion or controls weaknesses reported in the management letter when preparing the confirmation letter, especially when such exceptions relate to systems and controls to monitor and manage transactions from the non-statutory trust and associated credit risk. For example, there is no guidance on the situations in which a CASS auditor should refuse to issue a letter or rescind a previously issued letter, the associated mechanisms for doing so or the related implications on the firm and the auditor.

We therefore propose that the CASS Standard is expanded to provide further requirements and guidance together with a redrafted confirmation letter as follows:

- Altering the basis of the report to align with existing forms of assurance such as a reasonable assurance opinion or an agreed upon procedures report.
- Providing additional guidance on the level of evidence required to support the statement provided in the letter.
- Amending the letter to refer to a specific period or reference date.
- Increasing the guidance given over the work required to support the letter, including clarity over how the work undertaken in a reasonable assurance opinion can or should be relied upon and whether it is appropriate to prepare the letter as a standalone engagement.
- Providing a mechanism to issue qualified letters and guidance over how a CASS auditor should use judgement to identify qualifications in the letter.
- Providing guidance on the circumstances under which the letter should be re-issued and providing a mechanism for reviewing and either rescinding or re-issuing the letter, for example by requiring that it is reconsidered for re-issue alongside each subsequent reasonable assurance opinion.

We see the current consultation as an opportunity to provide clarity to firms, the FCA and to CASS auditors to reduce the risk that confirmation letters are inappropriately issued or wrongly relied upon.

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?

Yes, in the longer term. We believe however, that in the short term this change could be a distraction from other changes being made to the UK's system of auditor oversight and that it will be important that the change, when it happens, is adequately resourced:

- *Kingman review* - The Government is shortly to consult on the first steps to implement the Kingman review, which could result in the replacement or restructuring of the FRC.
 - a. One of the review's considerations was whether the FRC (or any successor) should focus more narrowly on corporate reporting or audit - we believe that this debate should be resolved and then the issue of responsibility for the oversight and inspection of CASS assurance engagements should be addressed. In any case, it would be helpful to all concerned if the CASS auditor oversight and inspection regime were changed once rather than potentially twice in short succession.

- b. Another question raised by the review was the degree to which the FRC (or any successor) should focus on public interest entities, on a wider class of entities, or on audit as a whole. We believe that this debate should be concluded, with a similar balance being struck depending on the significance of the CASS firms.
- *Skills and expertise* – The AQR’s staff are experienced in financial statement auditing, but many of them may not have carried out CASS assurance engagements under the CASS Standard nor have a recent understanding of the FCA’s CASS handbook. The FRC would, most likely, need to recruit additional staff to carry out this work. This could be a significant number of people if the requirement not to carry out a review at a firm where they were previously a partner or employee for at least three years is copied from the audit inspection regime – we believe this is a keystone of public confidence in the inspection system.

We suggest that, in the meantime:

- The Recognised Supervisory Bodies (“RSBs”) be asked to provide the FRC with a summary of their inspection and oversight work as it relates to CASS assurance engagements. This would address the short term need for the FRC to have information on the underlying quality of CASS assurance engagements set out in paragraph 8 of the call for evidence, pending a move of some or all of the oversight to the FRC or a successor body.
- The FRC and/or the RSBs report on their oversight of CASS assurance engagements to provide the FCA with more information on the quality of work (and the potential need for future changes to the CASS standard and/or the CASS rules themselves).
- A summary of the work in this area should be made public to promote transparency and public confidence. It may be helpful for this reporting to be combined with insight from the FCA as to the broader CASS regime, in the same way as the FRC’s role in respect of audit is ultimately about the degree of confidence of users of annual reports and the also FRC reports directly on their oversight of the corporate reporting regime.

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?

Yes.

The material on limited assurance engagements does not contain anything on communicating deficiencies in internal control to management and those charged with governance. Whilst the CASS auditor is not opining on controls in such cases, they may nevertheless become aware of control weaknesses (for example, a situation where, whilst client money and/or custody assets were not in fact held, there was a control missing which might mean they could inadvertently be held in future). It may be helpful to flag in this section of the standard that, whilst the likelihood of the auditor having observations is lower given the more limited nature of the work, they consider reporting such matters where they do arise.

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.

No.