ICAEW
REPRESENTATION 47/21

GUIDANCE IN 'PAYMENT SERVICES AND ELECTRONIC MONEY – OUR APPROACH' – CONSULTATION PAPER 21/3***

Issued 30 April 2021

ICAEW welcomes the opportunity to comment on 'Changes to the SCA-RTS and to the guidance in 'Payment Services and Electronic Money – Our Approach' and the Perimeter Guidance Manual Consultation Paper CP21/3**' published by the Financial Conduct Authority on 21 January 2021, a copy of which is available from this link.

Executive Summary

Our response does not address all of the consultations questions but is focused on the requirement for an annual compliance audit with safeguarding rules. We agree with the FCA's comments that poor safeguarding processes and controls, increases the potential for customers to face delays and shortfalls when trying to recover their funds. The assurance around safeguarding rules is therefore of critical importance. Below we set out four risks to achieving the FCA's objectives that it should address as soon as possible. The Annexes to this letter set out the detail to the points raised below. If any of our remarks are unclear, we would be happy to discuss these formally or informally and with relevant members of our 'CASS and Safeguarding Working Party' or with ICAEW staff, as required.

Risk 1 – Assurance providers do not know what standards to apply in performing the compliance audit

Any audit or assurance engagement must be performed in accordance with an assurance standard. The assurance standard provides a framework for the work that must be completed and the form of opinion that will be issued. The current consultation does not set out which assurance standard the audit should be performed under.

The requirement for assurance around the safeguarding requirements for payment and e-money firms is similar to the FCA's audit requirement around client assets (CASS). However, in the case of CASS there is a specific 92-page FRC Assurance Standard providing the framework under which CASS audits are performed. This specifies the requirements that assurance providers must follow when performing the audit and defines what the client assets report should look like. We note that this assurance standard is specific to CASS and as such could not be applied to other areas of regulatory assurance. While not unexpected for a new regulatory requirement, there is currently no similar standard in relation to the FCA's requirement for assurance around safeguarding requirements for payment and e-money firms. In the medium term, we think the FCA needs to work with the FRC (or its successor organisation, ARGA) to develop such a standard. However, in the short term the FCA needs

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to specify the standard that they expect the safeguarding assurance to be performed under. In our view the most appropriate standard would be ISAE 3000, which sets out generic guidance for assurance reports and is the assurance standard used for the FCA's Section 166 reports and other mandatory audits of regulatory compliance. Please see Annex A.

Risk 2 – The type of assurance the FCA requires in the compliance audit is not clear
The FCA's expectations on the extent of assurance they require is unclear and given that there are different types of assurance reports that could be issued there is likely to be different levels of testing performed.

For CASS there are two different types of assurance reports, but they have two different purposes in mind. For example, for some regulated firms the FCA requires them to commission a **limited assurance** report, to make sure they have not inadvertently held client money or assets as part of their business model or regulated activities. Some basic checks are done by the assurance provider and the report opinion confirms 'nothing came to our attention'.

For regulated firms which do have client asset permissions and do hold client assets the FCA requires them to commission a **reasonable assurance** report. Based on robust testing of controls, the report states positively that regulated standards were met.

The FCA should define the level of assurance required from the safeguarding compliance audits and may choose to borrow from the CASS 'model' and seek reasonable assurance opinions for firms which they know are undertaking payment services, issuing e-money, or holding relevant funds. The amount of work required to provide a reasonable assurance opinion is significantly greater than the work required to provide a limited assurance opinion. Please see Annex B.

Risk 3 – Many regulated firms are not ready to be audited so are not currently commissioning assurance reports
Prior to an assurance review being performed, it is essential that regulated firms have documented their control framework for complying with the safeguarding requirements. Based on the interactions of our assurance provider members with regulated firms, we note that many regulated firms are still in the process of defining and documenting their control objectives and their controls around safeguarding. As such, we are finding that some regulated firms are not ready for the assurance provider's 'audit' at present and are still in the 'preparation phase' for an audit – please see Annex C.

As assurance providers, our member firms are therefore unable to engage with regulated firms to start work. This will impact on the timing and progress of the first set of 'audits', and we would like to bring this to your attention.

For clarity, whilst many regulated firms may have been comfortable to attest hitherto that their own systems and controls are compliant, they may not have the formal documentation in place necessary for an external review, particularly around the control framework. Because the regulated firms are not ready, they may need a long lead time to commission a review.

Risk 4 – The timing for issuing reports is unclear
The FCA's temporary guidance published in July 2020, as well as the January 2021 consultation does not prescribe the required timing of submitting the safeguarding audit report, e.g. 'x' months after the period end date under review. We recommend that the FCA 'codifies' this timeline in the guidance, as well as a mechanism to notify the FCA, should this timeline not be met. Please see Annex D.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 186,500 chartered accountant members and students around the world. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

KEY ACTIONS TO MITIGATE RISKS TO THE FCA'S OBJECTIVES

Risk	Action
1. Assurance providers do not know what standards to apply in performing the compliance audit **The FCA do not specify under which framework the assurance reviews should be performed which could lead to different types of reviews and differing levels of assurance being given. It is necessary for the scope of the audit and the framework under which the audit is performed to be specified.** **There is no specific assurance standard for Safeguarding audits.**	1. The FCA Rules should state the required assurance framework. We would expect this to be ISAE 3000 as the appropriate Reasonable Assurance standard. [July 2021] 2. The FCA to work with the FRC/ARGA to develop such a standard. [2021/2022]
2. The type of assurance the FCA requires in the compliance audit is not clear **If different assurance providers perform different types of assurance review, and perform work to different standards, the inconsistency will lead to a lack of comparability between audit reports.** **There is also an expectation gap as some assurance engagements may not meet the needs of the FCA and/or are inadequate to identify the risks of consumer harm.** **This is a probable risk as assurance providers may infer from the FCA's Cost benefit Analysis data points that the form of assurance required, is limited.**	FCA rules should state the type of assurance required. In our view, the most appropriate would be a 'Reasonable Assurance' review for regulated entities performing safeguarding activities [July 2021]. In due course, the FCA to consider issuing generalised control objectives for regulated firms and assurance providers to use as a framework to build the scope.
3. Many regulated firms are not currently ready for an audit **Many firms are still in the process of defining and documenting their control framework for compliance with the safeguarding requirements and will not be ready for an audit until this is completed. Our members are unable to engage with firms until they are ready, so this is likely to impact the timing and progress of these audits.**	The FCA to communicate to regulated firms their expectations around firm readiness for external review and timing of the first reports.
4. Timing **The FCA's temporary guidance published in July 2020, as well as the January 2021 consultation does not prescribe the timing of submitting the safeguarding specific audit report, e.g. 'x' months after the period end date under review.**	The FCA to 'codify' this timeline in the guidance, as well as a mechanism to notify the FCA should this timeline not be met.

ANNEX A

1. Why an assurance standard is necessary

Importance of an assurance standard

In order to meet the requirement that the auditor give an 'opinion', there needs to be a relevant assurance standard under which that opinion can be given. That standard will, in turn, require the subject of the report to be assessed against a suitable reporting framework.

The assurance standard enables the assurance provider to evaluate the subject matter against a specific set of criteria that provide a frame of reference. This may be a set of regulations e.g. for a food hygiene rating, a car MOT or a Home buyer survey. Without this, the assurance provider's conclusion is open to individual interpretation and misunderstanding and there is no clear basis against which the assurance provider can assure information on a consistent basis. With the criteria set out in the standard, the expert can then undertake a review process and exercise their skills, experience and judgment to arrive at the conclusions they report back to the user of the information. This is important to ensure that responsibilities and expectations of the regulated firm (as well as Directors/Senior Management within the firm), the auditor and any other stakeholders are clear. This includes in respect of the independence requirements that should be adhered to.

In the absence of a specific assurance standard in our view, the most appropriate professional standard is ISAE 3000 (Revised).

Why ISAE 3000

While there are various standards that may be applied, we believe this is the most appropriate. Under this standard there is scope for reporting on:

(i) controls designed and implemented at a point in time,
(ii) controls operating throughout the period, and
(iii) compliance with rules as at a period end date. This is subject to the existence of suitable criteria and an appropriate subject matter.

ISAE 3000 is also the standard used in other areas of mandatory external audit reporting against regulations issued by the FCA, including MAR8, Benchmark Regulation and Primary Information Providers.

Further, ISAE 3000 is an international assurance standard. Use of the standard would therefore help when, and if, passporting PIs and EMIs from the EU established domiciles in the UK and therefore also require an external audit, as well as providing reporting against a framework which would be recognised by organisations and auditors across Europe.

ANNEX B

2. Differences between Reasonable and Limited Assurance

The ISAE 3000 framework facilitates both Reasonable and Limited Assurance reports to be provided. The assurance provider uses the same risk basis for planning their work and the same levels of materiality in evaluating the outcome of tests for Reasonable and Limited Assurance engagements. However, there are some key differences between the two forms of assurance.

	Reasonable Assurance	Limited Assurance
Overall audit effort	Considerable audit effort deployed to test compliance with regulations.	Less audit effort. The practitioner collects less evidence, performing different or fewer tests or, uses smaller sample sizes for the tests performed.
Testing	Detailed and substantive testing • auditors test design (whether they address the risks they are intended to and whether there are any gaps) and operating effectiveness of the controls • a review of each control, including meetings with control owners, review of several transactions, review examples of the control operating, • A review of existing policy and procedure documents, to demonstrate that the control was in place at the period end date. • test a sample of control instances during the period under audit to demonstrate that these controls are in operation over the period being reported on. • Evidence of the operation of each control instance will need to be obtained and inspected in order to perform this testing.	Test procedures are fewer and far less extensive: • basic inquiries of the entity's personnel and analytical procedures. • controls would typically not be tested in a limited assurance engagement. • few scenarios where sample based testing is used in a limited assurance engagement, fewer items would be tested.
Costs	Average cost - £122,000 CASS large firms - £177,000 to £272,000 (average of £209,667). CASS medium firms - £18,000 to £270,000 (average of £106,953).	Lower costs £6,000 to £12,000. (Source: FCA Consultation 21/3***, Paragraph 100)

	(Source: Baringa 2020 CASS Insight Survey)	
CASS use cases	Used for CASS firms which do hold client money or assets.	Used for CASS firms which do not hold client money or assets.
Opinion	Positive opinion An opinion on the adequacy of controls or the firm's compliance with regulations and whether a firm is, or is not, in compliance with a subject matter. *e.g. 'based on the procedures performed, in our opinion, the management assertion on [subject matter] is properly prepared'*	Negative opinion *Eg, 'nothing has come to the auditor's attention to indicate that client money and/or assets have been held.'* The level of risk of material misstatement remaining is potentially higher than in a reasonable assurance engagement.

Opinion

The conclusion in a Limited Assurance engagement is accordingly framed in a negative sense: 'Based on the procedures performed, nothing came to our attention to indicate that the management assertion on XYZ is materially misstated.' In contrast with a Reasonable Assurance conclusion which would be formed in a positive sense, i.e. 'Based on the procedures performed, in our opinion, the management assertion on XYZ is reasonably stated.'

Testing

An audit of controls' effectiveness is ordinarily conducted with sufficiently detailed test procedures to enable the auditor to express its opinion positively (i.e. provide reasonable assurance). This would enable the auditor to opine on:

- whether the firm has maintained organisational arrangements adequate to enable it to meet the FCA's expectations of its compliance with the safeguarding provisions of the EMRs/PSRs (as set out in chapter 10 of our Approach Document), throughout the audit period, and
- whether the firm met those expectations as at the audit period end date.

It is also possible for the auditor to conduct test procedures which, whilst not sufficient to enable them to express a positive assurance, could enable them to express a 'limited assurance' opinion. To provide some context, in CASS audits, this type of assurance is ordinarily provided in respect of firms who are regulated to carry out investment business, insurance mediation business etc, but **do not hold client money or assets in practice**. In these cases, the opinion concludes that *nothing has come to the auditor's attention* to indicate that client money and/or assets have been held. **This form of opinion does not include an opinion on the adequacy of controls** or the firm's compliance with regulations. This is therefore very much a limited form of assurance requiring less audit effort and therefore lower costs.

As the level of assurance provided in a limited assurance engagement is lower than in a Reasonable Assurance engagement, the procedures an assurance provider would perform will be fewer and far less extensive.

The primary differences between the procedures for a reasonable assurance engagement and a limited assurance engagement include:

- The emphasis placed on the nature of testing procedures will differ. For example, limited assurance may place greater emphasis on basic inquiries of the entity's personnel and analytical procedures. There will be little, if any, substantive testing.
- Controls would typically not be tested in a limited assurance engagement.
- An opinion over whether a firm is, or is not, in compliance with a subject matter would only be provided in a reasonable assurance engagement.
- In the few scenarios where sample-based testing is used in a limited assurance engagement, fewer items would be tested.
- Once Institutions are ready to engage a third party to carry out assurance procedures, the auditor will need to carry out an independent exercise on the design of the controls, whether they address the risks they are intended to and whether there are any gaps. This includes a review of each control, including meetings with control owners, review of several transactions/examples of the control operating, and review of existing policy and procedure documents, to demonstrate that the control was in place at the period end date.
- The auditor will subsequently need to test a sample of control instances during the period under audit to demonstrate that these controls are in operation over the period being reported on. Evidence of the operation of each control instance will need to be obtained and inspected in order to perform this testing.

Given the guidance provided by the FCA on 9 July 2020 that will be made permanent per the January C/P, we believe additional guidance to institutions and assurance providers is required to clarify their expectations and establish consistency, including the framework which should be used for reporting purposes.

Costs

In the FCA's recent consultation paper published in January 2021, you have provided a cost benefit analysis to consider the impact of the annual safeguarding audit requirements under EMRs and PSRs. ICAEW welcomes such analysis as it can be beneficial for both assurance providers and regulated entities. However, we have questions around some of the key assumptions and, in particular the nature of audits and the data points which have been used to benchmark these costs.

As explained above, there is a significant difference between a Reasonable Assurance opinion and a Limited Assurance opinion. We would like to understand whether the FCA's expectations for an annual safeguarding audit is consistent with the type of audit used to prepare the cost benefit analysis. There is a risk that a significant gap in expectations may exist, which could lead to inconsistency in the nature of audits performed.

We recognise the sensitive nature of this topic and the considerations of competition law. Therefore, we have used publicly available information in the matters set out below.

As detailed in the CP, the EMRs and PSRs safeguarding requirements have been compared to the firms subject to the rules in the FCA's Client Asset Sourcebook (CASS). We think this is a reasonable comparison considering the nature of both regulations being the protection of client assets. However, as we have detailed in the section above, a significant consideration is the nature of the opinion that will be provided. In respect of the CASS audits, as set out in the FCA's Supervision Manual (SUP rules), regulated firms may require a Reasonable Assurance audit or a

Limited Assurance audit. In the majority of cases, firms will be obtaining a Limited Assurance opinion.

As detailed in the ICAEW's Buyer's guide to assurance on non-financial information, for a Limited Assurance engagement the practitioner collects less evidence than for a reasonable assurance engagement but sufficient for a negative form of expression of the practitioner's conclusion. The practitioner achieves this ordinarily by performing different or fewer tests than those required for reasonable assurance or using smaller sample sizes for the tests performed. The practitioner uses the same risk basis for planning their work and the same levels of materiality in evaluating the outcome of tests for reasonable and limited assurance engagements. Since the extent of evidence collected for a limited assurance engagement may be limited due to the reduced sample sizes and test coverage adopted, the level of risk of material misstatement remaining is potentially higher than in a reasonable assurance engagement. Hence, the practitioner is not in a position to express the same degree of confidence as in a reasonable assurance engagement.

The conclusion in a Limited Assurance engagement is accordingly framed in a negative sense: 'Based on the procedures performed, nothing came to our attention to indicate that the management assertion on XYZ is materially misstated.' In contrast with a Reasonable Assurance conclusion which would be formed in a positive sense, i.e. 'Based on the procedures performed, in our opinion, the management assertion on XYZ is reasonably stated.'

As further detailed in our considerations above, the guidance provided by the FCA states that 'we expect the auditor to provide an opinion… on whether the firm has maintained organizational arrangements adequate to enable it to meet the FCA's expectations of its compliance with the safeguarding provisions… throughout the audit period, and whether the firm met those expectations as at the audit period end date'. Per the feedback statement, it notes that 'the purpose of the audits is to document reasonable assurance of compliance with the safeguarding requirements ….'. Based on this, in our view, we would expect that the FCA requires a Reasonable Assurance audit and this needs to be considered in any cost analysis as it will significantly impact the work involved in the engagement and therefore the associated costs.

To further consider the costs of these safeguarding audits we have used the Baringa 2020 CASS insight survey which is publicly available (here). The survey consisted of more than 100 questions and recorded detailed information on CASS audits with around 50 participants providing responses. Per the responses, 98% of the firms who responded were either CASS Small, Medium or Large. As a result, these firms would have been subject to a Reasonable Assurance CASS audit and therefore we think this is a good point for comparison.

Per the analysis, the average cost of the reasonable assurance CASS audit was £122,000, but it is recognised that there was an inevitably large range between firms. Of the CASS large firms, the range of fees was between a low of £177,000 to a high of £272,000 with an average of £209,667. Comparably the CASS medium firms ranged from £18,000 to £270,000 with an average of £106,953. This is therefore significantly higher than the range quoted in the consultation.

We recognise that the consultation makes it clear that the costs of carrying out a compliance audit will vary by auditor, as well as by the size and complexity of the firm. However, we think there is a considerable expectation gap as a result of the assumptions set out in the paper compared to our expectations of the costs of these audits. This gap raises challenges as our members scope the work we believe necessary to deliver these opinion and also receives challenge from regulated

entities, in terms of the variance from the analysis in the CP and the scope of work proposed by our members.

ANNEX C

3. Readiness of Entities for Safeguarding audit

Preparation by Institutions

As explained above, we are proposing to use the ISAE 3000 framework for these audits which require control objectives to be identified by the regulated entities. The regulated entities are required to identify and document the controls they have in place to meet those objectives, and assurance providers test the design and operating effectiveness of the controls. For assurance providers to start their work, regulated entities need to be ready and should have these controls documented and mapped to the safeguarding requirements. This typically needs to be done **before** any assurance can be provided, otherwise the practitioner risks breaching independence by acting in the role of management.

In our previous correspondence we noted the following in respect of the steps which need to be taken before an assurance opinion can be issued:

1) The fundamental first step is consistent reporting and compliance by the institutions, with or without assurance.
2) We understand from the FCA's guidance that evidence has been found that some institutions are not complying with the regulations as expected. We therefore anticipate that each institution will have to undertake an exercise to identify, and perhaps implement or remediate, adequate controls prior to any management statement as to adequate controls (and prior to any audit in relation to those controls).
3) Institutions should focus initially on designing the appropriate controls and putting them into place. In order for an assurance provider to assure the design and implementation of controls there is an expectation of the controls having been live for at least 3 months.

It is important to note that in order for institutions to be 'ready' for an audit of compliance, they may need to carry out the following preparatory steps (if not already done):

1) Carry out a design assessment to assess whether there are existing controls to meet the regulations.
2) Map controls against each of the requirements within the regulations to ensure there are no gaps.
3) Identify whether controls need to be implemented or remediated.
4) Ensure that there is a supporting audit trail to evidence the operation of the controls on an ongoing basis.
5) Operate and evidence these controls for an adequate period of time.

Importantly, it is advisable to provide regulated firms sufficient time to support their control and compliance reporting with sufficient evidence, both for management and audit purposes including, where relevant, designing and establishing the required controls and structures commensurate with the regulation. **As above, this typically needs to be done before any assurance could be provided, otherwise the practitioner risks breaching independence by acting in the role of management.**

Based on our members interactions with the regulated firms, we note that many regulated entities are still in the process of defining and documenting the control objectives and controls. As such, we are finding that they are not ready for the audit at present and are still in the preparation phase for the audit. We understand, that the FCA believes that 'compliance attestations' previously submitted by institutions should mean that firms are in a position where they can be subject to an audit. It is important to note that a self-attestation on 'compliance' is different to having fully embedded and operating controls that can be readily evidenced in such a way that would enable them to be subject to audit. Proper articulation and documentation of the control framework and controls can take significant effort and time to complete. Some regulated entities have also engaged advisors to carry out a gap analysis or are in the process of doing that. As assurance providers, our members are unable to engage with firms to start our work unless the control framework, including controls have been documented. As this is likely to impact the timing and progress of these audits, we would like to bring this to your attention.

From the experience of our members to date some regulated entities have taken the advice of certain advisory firms to carry out some or all of these steps, while others have not. Those organisations that have started their first external compliance audit are likely to have highly qualified or adverse opinions, particularly where little preparatory work has been performed. We know many institutions have concerns regarding the speed at which they have been required to enter into full period cyclical testing.

ANNEX D

4. Timing

The FCA's temporary guidance published in July 2020, as well as the January 2021 consultation does not prescribe the timing of submitting the safeguarding specific audit report, e.g. 'x' months after the period end date under review. We recommend that the FCA 'codifies' this timeline in the guidance, as well as a mechanism to notify the FCA should this timeline not be met, similar to a CASS audit as set out under SUP 3.10.7 and SUP 3.10.8 respectively.

In 'codifying' this timeline, the FCA should take into consideration the timing of submission relative to statutory audit reporting. Under the FCA's current approach document Section 13.8, it states 'If the accounts are audited and filed with Companies House they should be sent to us at the same time', which would be up to nine months after the period end date. We expect that the safeguarding audit work would be done in parallel with the statutory audit in order to gain as much efficiencies and synergies where 'common processes and controls' operate for both financial reporting and meeting its safeguarding obligations. Therefore, should a firm utilise the full nine months for statutory reporting, the timing of the safeguarding audit should follow suit.

Specifically in relation to first year adoption of this safeguarding specific audit, as we have outlined above, the auditor's ability to carry out an audit which meets the requirements of the ISAE 3000 framework is dependent on the readiness of the regulated entity to be audited.

This will have an impact of extending as well as a delay in the timing of the assurance provider's work. Given the work required around the readiness of a number of regulated entities for safeguarding audits we have outlined, we recommend a transitional period is introduced with respect to the timeline for submitting the safeguarding audit report at least for the first three years of this requirement being introduced from July 2020.

Overall considerations

Whilst we appreciate that the FCA would like institutions to arrange audits as soon as possible, the number of steps that need to be taken (as outlined above) are what drove us to originally suggest to the FCA a two-step approach to reporting and assurance as follows:

Stage 1 - A 'Type 1' (point in time) report with conclusions over:

- The design and implementation of controls in relation to the control objectives as at a defined date; and
- Compliance with regulations as at the defined date.

Stage 2 - For the second audit (a year later, **and** annually thereafter), a 'Type 2' report with conclusions over:

- The design of controls throughout the specified period;
- The implementation of controls in relation to the control objectives throughout the specified period; and
- Compliance with regulations as at the period end.

When considering the additional guidance, including the timelines firms are expected to work to, we request the FCA to consider this phased approach.