



November 2019

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# Providing Assurance on Client Assets to the Financial Conduct Authority

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# Providing Assurance on Client Assets to the Financial Conduct Authority



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# CLIENT ASSET ASSURANCE STANDARD

## PREFACE

*This Client Asset Assurance Standard contains requirements indicated by paragraphs in bold type, with which a CASS auditor is required to comply in the conduct of an engagement to report to the Financial Conduct Authority in respect of Client Assets.*

*The Client Asset Assurance Standard also includes implementation guidance, including appendices, in the context of which the requirements are to be understood and applied. It is necessary to consider the whole text of the Client Asset Assurance Standard to understand and apply the requirements.*

*The Client Asset Assurance Standard is the material referred to in SUP 3.10.5B G to which the FCA expects CASS auditors to have regard for reports for periods commencing on or after 1 January 2016.*

*For the purposes of the Client Asset Assurance Standard the term “client assets” encompasses “client money” and “custody assets” as defined by the FCA’s “Glossary”. Notwithstanding that the engagement is not an audit, the generally accepted expression CASS auditor is used in the Client Asset Assurance Standard to refer to the persons conducting the CASS assurance engagement.*

*Attached to the Client Asset Assurance Standard is contextual material which is intended to provide a non-technical introduction to, and overview of, the Client Asset Assurance Standard. This does not form part of the Standard.*

# CLIENT ASSET ASSURANCE STANDARD

## INTRODUCTION

### Scope of this Standard

1. This Client Asset Assurance Standard (Standard) establishes requirements and provides guidance for CASS auditors reporting to the Financial Conduct Authority (FCA) in accordance with its SUP (Supervision Manual) rules in respect of engagements that involve evaluating and reporting on a regulated firm's (firm) compliance with the FCA's CASS (Client Asset) rules and other rules relevant to the holding of client assets.
2. Arising from the nature of insolvency law, client asset protection (including the CASS rules) is structured on the basis of the legal entities that hold client assets rather than in the context of the business structures (e.g. a consolidated group) within which a legal entity operates. This Standard, therefore, is applicable to the CASS audit of each firm that is required to have a CASS audit pursuant to SUP 3.
3. If client assets are transferred to another legal entity such as a sub-custodian or third-party administrator the CASS auditor will need to have a clear understanding regarding which client assets are within the scope of the CASS rules on which it has a responsibility to provide assurance and to report Breaches of those rules, where appropriate.
4. "CASS audit" describes the work performed by a "CASS auditor" in providing a client assets report to the FCA. Strictly, such engagements are assurance engagements rather than audit engagements; however, the terms "CASS audit" and "CASS auditor" are used because they are commonly used and well understood expressions. The use of these expressions is not intended to change the nature of the engagement to that of an audit.
5. More specifically, the Standard establishes requirements with respect to:
  - a. The process for forming, and the expression of, reasonable assurance opinions;
  - b. The process for forming, and the expression of, limited assurance opinions;
  - c. The provision of reasonable assurance to the FCA with respect to a firm's proposed adoption of:
    - i. The alternative approach to client money segregation; and
    - ii. A non-standard method of client money reconciliation<sup>1</sup>; and
  - d. CASS auditor confirmations in respect of non-statutory client money trusts.

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1 In this Standard CASS auditor's reports on adoption of the alternative approach to client money segregation and the non-standard method of client money reconciliation are collectively referred to as "Special Reports".

6. This Standard is the material published by the Financial Reporting Council referred to in SUP 3.10.5B G, that deals specifically with the client assets report which the auditor is required to submit to the FCA, to which the FCA would expect CASS auditors to have regard.
7. The Standard contains references to, and extracts from, certain legislation and the CASS, SUP and SYSC rules of the FCA. These references are not intended to provide CASS auditors with the requisite knowledge of that legislation or those Rules. CASS auditors should have the requisite knowledge of those FCA rules that are relevant to the engagement. Readers are cautioned that the legislation and FCA Rules may change subsequent to publication of this Standard such that the references may no longer be accurate. The latest version of extant FCA rules can be found on the FCA website at: <https://www.handbook.fca.org.uk/>.

### **Effective Date**

8. This Standard is effective for reports to the FCA with respect to Client Assets for periods commencing on or after 1 January 2020.

## OBJECTIVES

9. The key objectives of the CASS Assurance Standard are to:
  - a. Support high quality CASS audits and other CASS assurance engagements;
  - b. Adequately support and challenge CASS auditors when undertaking CASS assurance engagements and, in particular, to define the nature and extent of the work effort required for both reasonable assurance and limited assurance CASS assurance engagements without undermining the importance of the CASS auditor's judgment;
  - c. Support the objectives of the FCA's Client Asset Regime regarding the effective safekeeping of client assets and client monies and in particular to guard against systemic failure of the CASS Regime;
  - d. Manage the expectations of:
    - i. The management of firms that hold client assets; and
    - ii. Third party administratorswhen a CASS auditor is engaged to provide assurance to the FCA on client assets that they handle or account for;
  - e. Support the effective training of CASS auditors by both the accounting bodies and other training organisations;
  - f. Help to establish realistic expectations regarding the integrity of the UK Client Asset regime with the beneficial owners of client assets; and
  - g. Underpin the effectiveness of the FRC's enforcement and disciplinary activities with respect to CASS assurance engagements.

## DEFINITIONS

10. For the purposes of the Client Asset Assurance Standard the following terms have the meanings attributed below:

*Applicable criteria: The CASS rules and other applicable rules used, in the context of the particular CASS assurance engagement, to evaluate the status of a firm, in terms specified by the FCA, in connection with subject matter relating to the holding of client assets. Related assertions are the conditions that need to be met, as expressed or implied by the applicable criteria, if the firm's status could be described in the terms specified by the FCA.*

*Breaches schedule: Part 2 of the Client Assets Report: A Breaches Schedule identifying each CASS rule in respect of which a breach has been identified in the course of the CASS assurance engagement for the period covered by the Client Assets Report, whether identified by the CASS auditor or disclosed to it by the firm, or by any third party.*

*CASS: The Client Assets Sourcebook of the FCA.*

*CASS assurance engagement: An engagement in which a CASS auditor expresses an opinion designed to enhance the degree of confidence of the FCA concerning the status of a firm, in terms specified by the FCA, in connection with subject matter relating to the holding of client assets. CASS assurance engagements include CASS audits and certain other engagements to provide assurance to the FCA with respect to special reports or non-statutory client money trusts.*

*CASS assurance engagement risk: The risk that the CASS auditor expresses an inappropriate opinion when the subject matter information is materially misstated.*

*CASS audit: A client asset assurance engagement that involves providing a Client Assets Report to the FCA.*

*CASS auditor: The person or persons conducting the CASS audit or other CASS assurance engagement, usually the CASS engagement leader or other members of the engagement team, or, as applicable, the auditing firm. Where a requirement expressly intends that it be fulfilled by the CASS engagement leader the term "CASS engagement leader" rather than "CASS auditor" is used. (N.B. A CASS auditor need not be the firm's statutory auditor).*

*CASS auditor's report: The report of the CASS auditor as required in the context of the CASS assurance engagement – in the case of a CASS audit, the Client Assets Report.*

*CASS engagement leader: The individual charged by the CASS auditor to be responsible for signing the CASS auditor's report.*

*CASS engagement team: All partners and staff performing the CASS assurance engagement, and any individuals engaged by the auditing firm who perform procedures on the engagement. This excludes any external experts engaged by the auditing firm.*

*CASS records: The records of accounting entries and other records, both manual and electronic, that comprise or support the information system that accounts for the receipt, segregation, custody, monitoring, reconciliation, transfer and return of client assets, and for the safeguarding of clients' rights relating to such assets while they are held by the firm, in accordance with the CASS rules and other applicable rules.*

*CASS rules: The rules set out in CASS as denoted by the suffix R.*

*Client assets: Generic term encompassing client money, safe custody assets, and mandates and collateral, if applicable.*

*Client Assets Report: The assurance report that the CASS auditor is required to submit to the FCA either to provide reasonable assurance as to whether a firm's systems are adequate to enable it to comply throughout the period, and as to whether it was in compliance at the end of the period, with the CASS rules or to provide limited assurance that the firm did not hold client assets during the period. For insurance intermediaries, the FCA's rules require the report to be submitted to 'the firm'.*

*CMAR: The Client Money and Asset Return.*

*Control risk: The risk that a breach of the CASS rules that could be significant in the context of the applicable criteria and related assertions will not be prevented, or detected and corrected, on a timely basis by related internal controls.*

*Credit risk: The risk that a borrower will default by failing to make required payments.*

*Detection risk: The risk that the CASS auditor will not detect, as applicable in the context of the CASS assurance engagement, a deficiency in the design, implementation or operation of the firm's systems that are intended to enable it to comply with the relevant CASS rules, or a breach of the CASS rules that would be significant in the context of its reporting responsibilities.*

*Engagement quality control review: A process designed to provide an objective evaluation, on or before the date of the report, of the significant judgments the CASS engagement team made and the conclusions it reached in formulating the CASS auditor's report.*

*Engagement quality control reviewer: A partner, other person in the accounting firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the CASS engagement team made and the conclusions it reached in formulating the CASS auditor's report.*

*Evaluation risk: The risk that the CASS auditor will fail to evaluate accurately the underlying subject matter against the applicable criteria and related assertions, in the terms specified by the FCA concerning the firm's status relating to the holding of client assets.*

FCA: *Financial Conduct Authority.*

Firm: *The regulated legal entity in respect of which the CASS auditor is reporting.*

FSMA 2000: *The Financial Services and Markets Act 2000*

Hybrid opinions: *Hybrid opinions are opinions that provide reasonable assurance with respect to one aspect of a firm's status relating to the holding of client assets and limited assurance with respect to another. For example, reasonable assurance may be provided with respect to the firm's compliance with the client money rules and limited assurance with respect to the custody asset rules because the firm's permissions do not allow it to hold custody assets.*

Inherent risk: *The risk of the management of the firm not preventing non-compliance with the CASS rules and other applicable rules due to the underlying susceptibility of the behaviour of the regulated firm to non-compliance with all of the applicable criteria and related assertions under those rules, before the application of internal controls.*

Limited assurance Client Assets Report: *A Client Assets Report providing a level of assurance where the engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but which is obtained when that risk is greater than the level of assurance that would be provided in a reasonable assurance Client Assets Report, as the basis for a negative form of expression of the CASS auditor's conclusion.*

Nominee Company: *A subsidiary of a firm in whose name custody assets of the firm are registered during the period.*

Practitioner: *A professional accountant in public practice.*

Reasonable assurance Client Assets Report: *A Client Assets Report providing a high but not absolute level of assurance, which is obtained when the CASS auditor has obtained sufficient appropriate assurance evidence to reduce assurance engagement risk to an acceptably low level in the circumstances of the engagement as the basis for a positive form of expression of the CASS auditor's conclusion.*

Re-performance: *The CASS auditor's independent execution of procedures or controls that were originally performed as part of the firm's internal controls.*

Reportable breach: *A breach of the FCA's rules of which the CASS auditor becomes aware which it reasonably believes may be of material significance to the FCA (see para 59).*

Significant deficiency in internal control: *A deficiency or combination of deficiencies in internal control relating to a firm's compliance with the CASS rules or other applicable rules that, in the auditor's professional judgment, is of sufficient importance to require the attention of those charged with governance.*

*Special Reports: The reports prepared by an independent auditor, subject to the provision of which, the FCA permits certain firms to use the “alternative approach” to client money segregation and a “non-standard method” of client money reconciliation under the CASS rules. In this Standard, both are referred to as “Special Reports”.*

*Subject matter information: The outcome of the evaluation by the CASS auditor of the underlying subject matter against the applicable criteria and related assertions, in the terms specified by the FCA concerning the firm’s status relating to the holding of client assets.*

*Those charged with governance: The person(s) or organisation(s) (for example a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the firm. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private firm or public sector entity, or an owner manager<sup>2</sup>.*

*Underlying subject matter: The matter(s) relating to the holding of client assets, in connection with which, in the context of the particular CASS assurance engagement, the CASS auditor is required to express an opinion concerning the firm’s status, in terms specified by the FCA.*

*In a CASS audit, the underlying subject matter is:*

- *when a reasonable assurance Client Assets Report is required – the firm’s state of compliance with relevant FCA rules (e.g. the CASS rules) and the design, implementation and operation of the firm’s systems intended to enable its compliance with such rules;*
- *when a limited assurance Client Assets Report is required – the firm’s holding of client assets to which such rules apply.*

*In a CASS assurance engagement relating to special reports or non-statutory client money trusts, the subject matter is the design and/or implementation of the firm’s systems intended to enable its compliance with specified FCA rules.*

*Walk-through test: Involves tracing transactions through the firm’s systems used to monitor and report on client assets.*

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<sup>2</sup> For discussion of the diversity of governance structures, see paragraphs A1–A8 of ISA (UK and Ireland) 260, ‘Communication with Those Charged with Governance’.



## **REQUIREMENTS APPLICABLE TO ALL CLIENT ASSET ENGAGEMENTS**

**Obtaining an understanding of the firm's business model and the permissions it has received from the FCA**

- 11. The CASS auditor shall obtain an understanding of the firm's business model that is sufficient to enable the CASS auditor to establish expectations about the existence or otherwise of client assets, including:**
  - **the nature of the services it provides to clients.**
  - **how it is remunerated for those services and other ancillary services.**
  - **the nature of any transactions which it undertakes with or on behalf of, or facilitates or advises on, for clients and how those transactions are executed or settled.**
  - **the nature of relationships within a group and with other related parties.**
  - **the sources and destinations of cash and other asset inflows and outflows in its own accounts and any accounts it holds or controls on behalf of clients and other parties.**
  - **the role of sub-custodians and third-party administrators.**

*Establishing the firm's scope of permissions*

- 12. The CASS auditor shall establish from responsible officials within the firm the scope of the firm's permissions from the FCA with respect to the holding or controlling of client assets.**
- 13. The CASS auditor shall also review the permissions, including any limitations and requirements, set out on the on-line register maintained by the FCA for consistency with both its understanding of the firm's business model and the permissions asserted by the responsible officials within the firm.**

**The application of this Standard to the specific circumstances of a firm**

***Opinions in reasonable assurance reports***

*Firm (within the ambit of SUP 3.10) has relevant permissions and asserts it holds client assets*

- 14. Where the scope of the firm's permissions includes the holding of client assets and the firm claims that it holds 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<sup>3</sup>.**

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**3** For example, at the time of writing reasonable assurance opinions are not required in relation to Insurance intermediaries not holding more than £30,000 at any time in the reporting period in a statutory client money trust.

15. The CASS auditor shall assess, based on its understanding obtained from meeting the requirements in paragraphs 11 to 14, whether the firm effectively identifies all circumstances when client assets may arise, including cases where it is unable to rely on exemptions, treats them as client assets in accordance with the CASS rules and reports them to the FCA (see paragraph 92). If the auditor becomes aware of categories of client assets that are not being treated as client assets, the CASS auditor shall promptly report this fact to both those charged with governance and the FCA and reflect this in the assurance engagement risk assessment.

### ***Opinions in limited assurance reports***

*Firm (within the ambit of SUP 3.10) has relevant permissions but claims it does not hold client money or custody assets*

16. Where the scope of the firm's permissions includes the holding of client money and/or custody assets, but the firm claims not to hold client money and/or custody assets, the CASS auditor is required by the FCA's rules to provide a limited assurance Client Assets Report. In such cases the CASS auditor shall comply, as applicable, with all the requirements of this Standard set out in paragraphs 11 to 64 and 142 to 162<sup>4</sup>. (N.B. The FCA rules do not require limited assurance opinions in respect of insurance intermediaries and certain other categories of firms).

*Firm (within the ambit of SUP 3.10) does not have relevant permissions*

17. Where the scope of the firm's permissions does not include the holding of client money and/or custody assets, the CASS auditor is required by the FCA's Rules to provide a limited assurance client assets report. In such cases the CASS auditor shall comply, as applicable, with the requirements of this Standard set out in paragraphs 11 to 64 and 142 to 162. (N.B. The FCA rules do not require limited assurance opinions in respect of insurance intermediaries and certain other categories of firms).

### ***Special Reports***

18. If the CASS auditor has been requested by the firm to provide a reasonable assurance report to the firm with respect to either the adoption of the alternative approach to client money segregation or a non-standard method of internal client money reconciliation, the CASS auditor shall comply with those requirements of this Standard that are applicable to the provision of such reasonable assurance reports as set out in paragraphs 11 to 64. The additional requirements pertaining to special reports are set out in paragraphs 164 to 171.

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<sup>4</sup> Paragraphs 16 and 17 are considered separately with respect to custody assets and client money. A hybrid Client Assets Report providing, for example, reasonable assurance on client money and limited assurance on custody assets is possible where the scope of the firm's permissions includes the holding of client money but not the holding of custody assets or vice versa (see paragraph 163).

### **Non-statutory client money trust under CASS 5**

- 19. If the CASS auditor has been requested by an insurance intermediary firm to provide a confirmation with respect to whether it has, and maintains, adequate systems and controls over non-statutory client money trusts, the CASS auditor shall comply with those requirements of this Standard that are applicable as set out in paragraphs 11 to 64. The additional requirements pertaining to non-statutory client money trusts are set out in paragraphs 172 to 177.**

### **Conduct of a Client Asset Engagement in accordance with this Standard**

*Complying with Standards that are relevant to the CASS Engagement*

- 20. The CASS auditor shall comply with all relevant requirements of this Client Asset Assurance Standard or shall meet the requirement in paragraph 21.**

*Departing from relevant requirements*

- 21. When, (only in exceptional circumstances), the CASS auditor judges it necessary to depart from a relevant requirement in this Client Asset Assurance Standard, the CASS auditor shall document the reasons for departing from the requirement and perform additional procedures to achieve the aim of that requirement.**

### **Ethical Requirements**

- 22. The CASS auditor shall comply with relevant ethical requirements, including those pertaining to independence.**
- 23. CASS auditors in the UK are subject to ethical requirements from two sources: the FRC Ethical Standard concerning the integrity, objectivity and independence of the auditor, and the ethical pronouncements established by the CASS auditor's relevant professional body. In practice, the UK recognised supervisory bodies have adopted, with minor modifications, The Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (the IESBA Code). The FRC is not aware of any significant instances where the relevant parts of the IESBA Code of Ethics are more restrictive than the FRC's Ethical Standard for Auditors.**

### **Engagement Acceptance and Continuance**

- 24. The CASS auditor shall accept or continue a Client Asset Engagement only when the CASS auditor:**
  - a. Has reason to believe that all relevant ethical requirements, including independence, will be satisfied;**
  - b. The CASS auditor is satisfied that those who are to perform the engagement, including the CASS engagement leader, have had appropriate training and will have the appropriate competence and capabilities; and**
  - c. The basis upon which the engagement is to be performed has been agreed between the CASS auditor and the firm, including the CASS auditor's reporting**

**responsibilities to the FCA and also the reporting (as set out in paragraph 135) of the most significant matters requiring attention, in the auditor's professional judgment, to those charged with governance.**

#### *Agreeing on the Terms of the Engagement*

- 25. The CASS auditor shall agree the terms of engagement with the firm by means of an engagement letter. The engagement letter shall cover all aspects of the engagement to report on client assets (and collateral and mandates if applicable) and shall be accepted in writing by the firm. In subsequent years of a recurring engagement the CASS auditor shall assess whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the firm of the existing terms of the engagement.**
26. Where the CASS auditor and the financial statement auditor are from the same auditing firm, the terms of the engagement may be included in a separate section of a composite engagement letter sent to the firm. Alternatively, the terms may be the subject of a separate engagement letter. This may be appropriate, for example, where the CASS engagement leader is not the same as the audit engagement partner or where the terms of the engagement have to be agreed by an official at the firm other than the official who agrees the terms of the financial statement audit.

#### **The Client Assets Report**

- 27. The content and wording of the Client Assets Report provided by the CASS auditor shall be as prescribed by the Rules of the FCA and follow the templates in SUP 3 Annex 1R. Any deviations in content and wording beyond those provided for either in the FCA's template, or the wording in the illustrative example reports set out in Appendices 2 to 8 of this Standard shall only be used with the prior agreement of the FCA. The latest version of extant FCA rules can be found on the FCA website at: <https://www.handbook.fca.org.uk/>.**
28. SUP 3.10 sets out the FCA's rules and guidance with respect to the duties of CASS auditors to report on client assets. Amongst other things SUP 3.10 establishes rules relating to:
- The period that a Client Assets Report may cover.
  - The time period allowed for the Client Assets Report to be delivered to the FCA and the firm.
  - The signing of the Client Assets Report.
  - Delivering a draft of the report to the firm.
29. The CASS auditor is required by SUP 3.10.8D R to deliver a draft of its Client Assets Report to the firm such that the firm has an adequate period of time (see paragraph 32) to consider its findings and provide the CASS auditor with comments explaining:

- a. The circumstances that gave rise to each of the breaches identified in the draft Client Assets Report; and
  - b. Any remedial actions that it has undertaken or plans to undertake to correct those breaches.
30. Such comments are required to be submitted to the CASS auditor on a timely basis i.e. before the CASS auditor is required to deliver its report to the FCA or to the firm. The comments are recorded by the CASS auditor in Column E of the Breaches Schedule.
- 31. In order to facilitate the processes outlined in the two preceding paragraphs the CASS auditor shall agree with the firm what constitutes “an adequate period of time” and record the agreement with the firm.**

### **Quality Control**

- 32. The CASS auditor shall comply with the applicable standards and guidance set out in International Standard on Quality Control (UK) 1, and the CASS engagement leader shall have sufficient competence in the provision of assurance on client assets to accept responsibility for the assurance opinions in respect of the Client Assets Report.**
- 33. The CASS engagement leader shall be satisfied that the assigned CASS engagement team collectively has the appropriate competence and capabilities to perform the engagement in accordance with this Standard and applicable legal and regulatory requirements.**
- 34. The CASS engagement leader shall be satisfied that they will be able to evaluate the objectivity and competence of any other practitioner, not part of the engagement team, where the assurance work of that practitioner is to be used, to an extent that is sufficient to accept responsibility for the CASS auditor’s report.**

### *Training*

- 35. The CASS engagement leader shall be satisfied that the CASS engagement team includes staff with experience in client asset work who, to the extent relevant to a particular engagement, have received training relevant to the circumstances of that engagement, for example in the following:**
- The FCA’s CASS Rules and applicable SUP<sup>5</sup> rules, in particular what constitutes a breach of the CASS Rules and the implications of the situations where the CASS rules require the CASS auditor to provide a Special Report to the firm.
  - A firm’s business model, such that reasonable expectations can be established throughout the CASS audit team as to the nature of client assets that the firm is likely to have (see paragraph 11).

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5 At the time of writing SUP 3 is the applicable SUP Rule.

- Assessing the design effectiveness of systems of internal control over client assets and evaluating whether the systems of internal control were in effect throughout the period and operating effectively.
- Practical challenges associated with the performance and review of client asset reconciliations.
- How the CASS rules seek to effectively segregate client assets within the context of applicable trust and insolvency law.

*Responsibilities of the CASS engagement leader*

- 36. The CASS engagement leader shall, within the context of their firm's quality control standards for assurance engagements, take responsibility for the overall quality of the engagement. This includes responsibility for:**
- a. Appropriate acceptance and continuance procedures being performed;**
  - b. The engagement being planned and performed (including appropriate direction and supervision) to comply with this and other applicable professional standards and applicable legal and regulatory requirements;**
  - c. Assessing whether the engagement team and any other practitioners they intend to consult have sufficient knowledge of the specific aspects of the industry within which the firm operates and its corresponding products;**
  - d. Appropriate documentation of the work performed on the engagement being maintained to provide evidence of the achievement of the CASS auditor's objectives and that the engagement was performed in accordance with this Standard and applicable legal and regulatory requirements;**
  - e. Appropriate reviews of the work performed on the engagement, including reviewing the engagement documentation, before the date of the Client Assets Report; and**
  - f. Appropriate consultation being undertaken by the engagement team on difficult or contentious matters.**

**Professional Scepticism, Professional Judgment, and requisite mind-sets**

- 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 evidence to support their reporting to the FCA and to those charged with governance.**
- 38. The CASS auditor shall plan and perform the engagement with an attitude of professional scepticism.** Such an attitude requires the CASS engagement leader and CASS engagement team to make critical assessments, with a questioning mind, of the validity of assurance evidence obtained and to be alert for evidence that contradicts or brings into question the reliability of documents or representations received.

39. The engagement team shall assess the plausibility of information and explanations provided to it by those charged with governance and management. Where appropriate the engagement team considers this in the context of their knowledge and their findings derived from other areas of work undertaken with the same firm, including, where appropriate, the statutory audit of the financial statements.

*Compliance and insolvency mind-sets*

40. In planning and performing the engagement, the CASS auditor shall adopt a compliance mind-set that acknowledges:
- a. the responsibility of the firm to comply with all applicable CASS rules and to actively manage all risks of non-compliance; and
  - b. the responsibility of the CASS auditor to report to the FCA all breaches of the CASS rules that it becomes aware of in the course of performing its work.
41. In planning and performing the engagement, the CASS auditor shall also adopt an insolvency mind-set which evaluates the firm's client asset processes including trust status, segregation, record-keeping and reconciliations on the presumption that the firm may become insolvent. An insolvency mindset in the context of CASS engagements requires the auditor to provide assurance that the records maintained by a firm 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). The CASS auditor shall also consider in planning their audit whether the firm holds client assets that may be subject to loss, diminution or delay in being returned to their legal owner in the event of insolvency.

## **Documentation**

42. The CASS auditor shall document:
- a. The overall assurance strategy, including the main areas of engagement risk arising from the firm's activities;
  - b. The assurance plan, including the resources that are planned to be deployed to deliver the plan; and
  - c. Any significant changes made during the engagement to either the strategy or the plan and the reasons for making such changes.
43. In addition to documenting the strategy and the plan, the CASS auditor shall prepare documentation regarding the execution of the engagement that provides a record of the basis for the assurance report that is sufficient and appropriate to enable an experienced CASS auditor, having no previous connection with the engagement, to understand:
- a. The nature, timing and extent of the procedures performed to comply with this Standard and applicable legal and regulatory requirements;
  - b. The results of the procedures performed, and the evidence obtained; and





## **Written Representations**

50. The CASS auditor shall request from appropriate officials of the firm written representations, including representations that the firm:
- a. acknowledges its responsibility for maintaining CASS records and systems of control in accordance with the rules of the FCA;
  - b. has provided the CASS auditor with all information that the officials are aware is, or may be, relevant to the CASS auditor's engagement, including any correspondence and notes of meetings with the FCA;
  - c. has provided access to all information and persons that the officials believe are relevant to the CASS auditor's engagement; and
  - d. has complied, as far as they are aware, with all relevant CASS Rules throughout the period and was in compliance with those Rules at the period end, other than in respect of those breaches which they have notified to the CASS auditor.
51. The date of the written representations shall be as near as practicable to, but not subsequent to, the date of the Client Assets Report.
52. Representations from appropriate officials of the firm cannot replace other evidence the CASS auditor could reasonably expect to be available. Although written representations may provide necessary evidence, they do not provide sufficient appropriate evidence on their own about any of the matters with which they deal. Furthermore, the fact that the CASS auditor has received reliable written representations does not affect the nature or extent of other evidence that the CASS auditor should obtain.

## **Planning and Performing the Engagement**

### *Planning*

53. The CASS auditor shall plan the engagement so that it will be performed in an effective manner, including setting the scope, timing and direction of the engagement, and determining the nature, timing and extent of those risk assessment and other planned procedures that are required to be carried out in order to achieve the objective of the CASS auditor, and to gather sufficient appropriate evidence in support of the auditor's reports to the FCA and those charged with governance.

### *Understanding the Underlying Subject Matter and Other Engagement Circumstances*

54. The CASS engagement leader and senior members of the CASS engagement team shall meet to discuss the susceptibility of the firm's client asset systems to breaches of the CASS Rules. Such discussions shall include among other things:
- a. The firm's business model and changes in the model from the preceding year.
  - b. New products and services introduced during the period.
  - c. Changes made to IT and other reporting systems during the period.

- d. **Developments in relevant laws and regulations which may impact on the assurance procedures to be undertaken.**
  - e. **Waivers and modifications of CASS rules received by the firm during the year and any individual guidance received from the FCA.**
  - f. **The implications of arrangements for third party administration of client assets.**
55. **Relevant matters shall also be communicated to members of the engagement team not involved in the meeting.**
56. **Where the firm has an internal audit function or a separate compliance function, that is required to review the firm's compliance with the CASS Rules, the CASS auditor shall obtain an understanding of its activities with respect to Client Assets. The CASS auditor shall consider the findings of the internal audit function and/or the compliance function, including findings in respect of breaches. This shall inform the CASS auditor's risk assessment.**

#### **The CASS auditor's duty to report to the FCA**

57. Under the Financial Services and Markets Act 2000 (FSMA 2000) (Communications by Auditors) Regulations 2001 CASS auditors have duties in certain circumstances to make reports to the FCA. A CASS auditor has a duty to report breaches of the FCA's Rules of which it becomes aware which it reasonably believes may be of material significance to the FCA. If a CASS auditor becomes aware of such breaches, it does not wait to report them to the FCA by means of the Breaches Schedule that it appends to its routine assurance reports to the FCA but reports in accordance with the guidance at Appendix 12 to this Standard.
58. **Where the CASS auditor has reason to believe that a matter (such as a breach of the CASS rules) does exist it shall obtain such evidence as is available to assess its implications for the CASS auditor's reporting responsibilities.**
59. A matter or group of matters is likely to be of material significance to the FCA when, due either to its nature or its potential financial impact, it is likely of itself to require investigation by the FCA.
60. **The CASS auditor shall report those matters that it believes to be of material significance to the FCA as soon as practicable.**
61. **The CASS auditor shall document:**
- a. **The facts and circumstances that caused it to believe that the circumstances (such as a breach of the CASS rules) giving rise to the matters existed; and**
  - b. **The basis for its conclusions as to whether the matters are, or are likely to be, of material significance to the FCA.**

**The documentation shall clearly demonstrate the CASS auditor's reasoning for its decision (as the case may be) to report, or not to report, the matter to the FCA.**

### **The CASS auditor's right to report to the FCA**

62. Section 342 of FSMA 2000 provides that no duty to which an auditor (including CASS auditors) of an authorised person (e.g. a firm) is subject shall be contravened by communicating in good faith to the FCA information or an opinion on a matter that the auditor reasonably believes is relevant to any functions of the FCA.
63. The scope of the duty to report can be quite wide particularly since, under the FCA's Principle for Businesses 11, a firm must disclose to the FCA anything related to the firm of which the FCA would reasonably expect notice. However, in circumstances where the CASS auditor concludes that a matter does not give rise to a statutory duty to report but nevertheless should be brought to the attention of the FCA, in the first instance the CASS auditor advises the directors, or equivalent, of the firm of its opinion. Where the CASS auditor is unable to obtain, within a reasonable period of time, adequate evidence that the directors, or equivalent, have properly informed the FCA of the matter, then the CASS auditor makes a report to the regulator without undue delay.
64. The CASS auditor may wish to take legal advice before deciding whether, and in what form, to exercise its right to make a report directly to the FCA in order to ensure, for example, that only relevant information is disclosed and that the form and content of its report is such as to secure the protection of FSMA 2000. However, the CASS auditor recognises that obtaining legal advice may take time and that speed of reporting is likely to be important in order to protect the interests of customers and/or to enable the FCA to meet its statutory objectives.

## **REQUIREMENTS APPLICABLE TO THE EXPRESSION OF REASONABLE ASSURANCE OPINIONS IN A CASS AUDITOR'S REPORT**

*The requirements and guidance in paragraphs 11 to 64 also apply to the expression of reasonable assurance opinions*

65. An overview of the process to form the opinion as to whether the firm has maintained systems adequate to enable it to comply with the relevant CASS rules for the period and that it was in compliance with the rules at the end of the period, along with the relevant considerations relating to various stages in the process, is depicted in the diagram in Appendix 1 .
66. The nature and extent of the CASS auditor's work will be a matter of professional judgment based, among other things, on its assessment of "assurance engagement risk". That is the risk that the CASS auditor expresses an unmodified opinion that the firm has maintained systems adequate to enable it to comply with the relevant CASS rules during the period or that it was in compliance with the relevant rules at the end of the period, when reporting to the FCA, in circumstances where such opinions are not correct.
67. Assurance engagement risk with respect to engagements to express a reasonable assurance opinion with respect to Client Assets can be represented by the following components:
  - a. Inherent risk: the risk of the management of the firm not preventing non-compliance with the CASS rules and other relevant FCA rules that are applicable to the firm due to the underlying susceptibility of the behaviour of the regulated firm to non-compliance with all of the assertions and related criteria under the applicable rules before the application of internal controls;
  - b. Control risk: the risk that a breach of the CASS rules that could be significant in the context of the assertions (see paragraph 68) will not be prevented, or detected and corrected, on a timely basis by related internal controls;
  - c. Detection risk: the risk that the CASS auditor will not detect a significant breach of the CASS Rules and will, therefore, fail to report the breach to the FCA; and
  - d. Evaluation risk: the risk that the CASS auditor will fail to measure or evaluate accurately, the underlying subject matter against the criteria.
68. The assertions and the related criteria that are applicable to the engagement may comprise a combination of:
  - a. Applicable provisions of the CASS rules;
  - b. Waivers and Modifications granted to the firm by the FCA; and
  - c. Individual guidance from the FCA to a firm.

69. In overview, building on the understanding of the firm's business model, in order to assess assurance engagement risk with respect to each of the above components the CASS auditor:
- a. Establishes those FCA rules (especially the CASS rules) which are relevant to the firm's circumstances, systems and procedures;
  - b. Establishes any other applicable criteria;
  - c. In respect of each relevant rule and other criterion, establishes what the objectives of the firm's related controls should be (control objectives) in order to ensure compliance by the firm with the relevant rule, waiver, modification or guidance;
  - d. Carries out a risk assessment and establishes appropriate quality control to address detection and evaluation risk; and
  - e. Determines the nature and extent of assurance procedures that will provide sufficient appropriate assurance evidence that the firm has met the relevant control objectives for the assertions and criteria.

## **Assessing CASS Assurance Engagement Risk**

### ***Inherent risk and control risk***

70. **To assess the risk of a firm failing to comply with the CASS rules, the CASS auditor shall obtain an understanding of the firm's organisational structure, operating environment, use of information technology<sup>7</sup> to support the application of the CASS rules, use of or reliance on third-parties, classes of transactions to which the CASS rules apply, cash flows and other engagement circumstances sufficient to:**
- a. **Enable the CASS auditor to identify and assess the risk of inappropriately expressing an unmodified opinion that the firm has maintained systems adequate to enable it to comply with the CASS Rules throughout the period;**
  - b. **Enable the CASS auditor to identify and assess the risk of inappropriately expressing an unmodified opinion that the firm was in compliance with the CASS Rules at the end of the period; and**
  - c. **Thereby, provide a basis for designing and performing procedures to respond to the assessed risks and to obtain reasonable assurance to support the CASS auditor's opinion.**
71. **The CASS auditor shall discuss with management the operation of the business, seek to understand what the firm has done to mitigate risk, the systems and procedures used by management to mitigate risk and read relevant management information, for example:**

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<sup>7</sup> In its assessment of information technology and the way in which it supports a firm's application of the CASS Rules, the auditor considers the approach to testing as set out in ISA (UK) 330 - *The Auditor's Responses to Assessed Risks*. The work required will vary dependent on the complexity of the IT dependent CASS controls and processes.

- Operations Manuals.
- The firm's documentation of systems and controls.

**72. In assessing the risk that the control environment may not be sufficient to prevent or detect a significant breach of the rules, the CASS auditor shall meet with senior management, the CASS Compliance Officer and, where applicable, the senior manager allocated overall responsibility for the firm's compliance with CASS, to confirm their understanding of the control environment, gained as set out in paragraph 71. The CASS auditor shall also consider other sources of information, for example:**

- Compliance monitoring and internal audit programmes and results.
- Records maintained by the firm of any rule breaches and notifications to the FCA that may have occurred during the period.
- CMAR submissions made by the firm.
- The results of recent inspection visits made by the FCA.
- The register of client complaints.
- Any Section 166 Skilled Persons Reports or other relevant external/internal reviews that may have been performed.
- Previous CASS audit findings and recommendations.

**73. The CMAR is submitted by the firm to the FCA and is intended to give the FCA an overview of firm-specific CASS positions and an overview of CASS holdings. The CASS auditor is not required to evaluate or report on the firm's compliance with the FCA's CMAR requirements.**

**74. The CASS auditor shall read the firm's CMAR submissions and assess their consistency with the CASS auditor's knowledge of the firm's business. If the CASS auditor's procedures reveal inconsistencies with CMARs, the CASS auditor seeks to understand the reasons for the inconsistencies.**

**75. The CASS auditor shall consider the firm's own risk assessment and perform procedures to provide a basis for the identification and assessment of risks that the firm:**

- Has not maintained systems adequate to enable it to comply with the CASS rules throughout the period; and**
- Has not complied with the CASS rules that apply to the business of the firm as at the period end date of the Client Assets Report.**

**Such risk assessment procedures shall consider each relevant CASS rule that applies to the firm and on which the CASS auditor is required to report.**

## **Determining the nature and extent of risk assessment procedures**

76. The CASS auditor does not evaluate and report on monetary amounts but on whether the firm has maintained adequate systems to enable it to comply, and on the firm's compliance, with the CASS rules. However, forming a reasonable assurance opinion requires the CASS auditor to evaluate the risks of the likelihood of rule breaches and the significance of such rule breaches to the validity of the opinions expressed in the client assets reasonable assurance report.
77. **The extent and nature of the CASS auditor's risk assessment procedures shall be driven by the CASS auditor's evaluation of the significance to its opinion of a firm's failure to maintain systems that are adequate to enable it to comply with a CASS rule. Evaluating "significance" involves a combined assessment of the likelihood of a firm failing to manage or mitigate a risk and the impact of that risk on whether client assets have been held and recorded in accordance with the CASS rules. The significance judgment provides part of the basis for:**
- a. **Determining the nature, timing and extent of risk assessment procedures;**
  - b. **Identifying and assessing the risk of non-compliance with individual CASS rules applicable to the engagement; and**
  - c. **Determining the nature, timing and extent of further CASS audit procedures to test the firm's compliance with the CASS rules.**

**When performing these risk assessment procedures, the CASS auditor shall consider each CASS rule that is applicable to the firm on which the CASS auditor is required to report.**

## **Responding to the assessment of Assurance Engagement Risk**

78. **Based on the CASS auditor's understanding obtained through its risk assessment procedures, the CASS auditor shall design and perform procedures to respond to the assessed risks and to obtain sufficient appropriate evidence to support the CASS auditor's reasonable assurance opinion.**

*Evaluating the design of the system of internal control*

79. **The CASS auditor shall evaluate whether the design of the system of internal control, if implemented and operated effectively, would provide reasonable assurance of compliance with those CASS rules that are relevant to the firm. Where changes are made to the system of internal control during the period, the auditor shall evaluate the design of the system of internal control both prior to and subsequent to the change.**
80. In this context the "design of the system of internal control" encompasses consideration of:
- a. The control environment including the firm's risk assessment processes;
  - b. Monitoring controls; and
  - c. Control activities designed to ensure compliance with the CASS rules.

Consideration of the control environment and monitoring controls is particularly important in a CASS engagement because the CASS auditor is required to form an opinion as to whether the firm has maintained systems adequate to enable it to comply with the CASS rules throughout the period.

*The Control Environment*

- 81. The CASS auditor shall obtain an understanding of the control environment relevant to client assets. When obtaining this understanding, the CASS auditor shall evaluate whether:**
- a. Management, with the oversight of those charged with governance, seeks to maintain a culture of honesty and ethical behaviour towards the beneficial owners of client assets; and**
  - b. The effectiveness of the control environment collectively provides an appropriate foundation for the other components of internal control, and whether those other components are not undermined by deficiencies in the control environment.**
82. Particular elements of the control environment that may be relevant to the auditor's evaluation include the following:
- a. Participation by those charged with governance;
  - b. Communication and enforcement of integrity and ethical values;
  - c. Management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge; and
  - d. Assignment of authority and responsibility.
- 83. The CASS auditor shall obtain an understanding of the firm's process for:**
- a. Identifying risks relevant to client assets and its compliance with the CASS rules applicable in the context of the engagement;**
  - b. Evaluating the significance of the risks;**
  - c. Assessing the likelihood of their occurrence; and**
  - d. Determining actions to address those risks.**
- 84. If the CASS auditor identifies a risk that management has failed to identify, the auditor shall obtain an understanding of why management's process failed to identify it and determine if there is a significant deficiency in internal control with regard to the firm's risk assessment process, either because that process was poorly designed or poorly applied and/or executed.**



### *Monitoring activities*

**85. The CASS auditor shall obtain an understanding of the major activities, including information technology and automated procedures that the firm uses to monitor<sup>8</sup> internal control relevant to its compliance with the CASS rules and how the firm initiates remedial actions in response to deficiencies in its controls. Where the firm has an internal audit or compliance function, which covers those major activities intended to deliver compliance with the CASS rules, the CASS auditor shall perform or obtain, as appropriate, and document:**

- **an evaluation of whether the function's organisational status and relevant policies and procedures adequately support the objectivity of the internal auditors, or compliance function;**
- **an understanding of the nature of the internal audit or compliance function's responsibilities with respect to client assets;**
- **an assessment of whether the function applies a systematic and disciplined approach, including quality control; and**
- **the activities the function has performed or intends to perform with respect to client assets.**

**86. As the CASS auditor has sole responsibility for the CASS audit opinion, the use of internal auditors to provide direct assistance to a CASS auditor is prohibited in a CASS audit performed in accordance with this Standard. The CASS auditor is likely to find the work and findings of the internal audit or compliance function to be useful in making its risk assessment<sup>9</sup>. The CASS auditor shall document its conclusion and the basis for this conclusion on how the work and findings of the internal audit or compliance function have impacted on the risk assessment, having firms assessed the scope and extent of the work carried out and the competence of the internal audit function<sup>10</sup>.**

**87. The CASS auditor shall obtain an understanding of the sources of the information used in the firm's monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for the purpose.**

**88. Much of the information used in monitoring may be produced by the firm's information systems. If management assumes that data used for monitoring are accurate without having a basis for that assumption, errors that may exist in the information could potentially lead management to incorrect conclusions from its monitoring activities.**

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8 Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions.

9 Where the conditions of ISA (UK) 315 - *Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment* are met.

10 In accordance with ISA (UK) 610 – *Using the Work of Internal Auditors*

*Evaluating the design of control activities*

- 89. The CASS auditor shall consider how the design of control activities:**
- a. Enables the firm to identify where client assets may arise in the business;**
  - b. Seeks to ensure that client assets are segregated and safeguarded effectively;**
  - c. Addresses the performance of internal and external reconciliations<sup>11</sup> as required by the CASS rules; and**
  - d. Addresses the establishment and acknowledgement of trust status over client assets.**
- 90. In the context of the CASS auditor's consideration required by paragraph 89, the CASS auditor shall evaluate:**
- a. Whether the system design identifies appropriate control activities in respect of those CASS rules that are applicable to the firm;**
  - b. Whether those control activities are likely to provide reasonable assurance of compliance with the relevant CASS rules;**
  - c. The implications of different controls for different parts of the business; and**
  - d. Where appropriate, whether detective controls will be effective within the time periods (if any) permitted by the CASS Rules.**
- 91. The CASS auditor shall further evaluate:**
- a. Whether there is adequate segregation of duties; and**
  - b. Whether the design of the system incorporates sufficiently robust controls over system changes.**

**Obtaining evidence to support the opinion as to whether the firm has maintained systems over client assets adequate to enable it to comply with the relevant CASS rules during the period.**

*Evaluating whether internal control activities were put into place as designed and whether their operation was effective*

- 92. The CASS auditor shall evaluate whether internal control activities were put into place to cover all client assets and whether they were designed effectively. Based on the conclusions reached, the CASS auditor shall adopt a suitable approach to test the effectiveness of the operation of these controls during the period. The CASS auditor's procedures to evaluate whether control activities were put into place as designed shall include walk-through tests of internal control activities. Based on these evaluations, the CASS auditor shall adopt a suitable approach to test the effectiveness of operation of these controls during the period.**

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<sup>11</sup> Or bank reconciliations for insurance intermediaries.

93. The nature and extent of the auditor's evaluation will be a function of the results of its risk assessment and conclusions regarding the design effectiveness of the internal controls. In addition to the performance of walk-through tests, relevant procedures the CASS auditor considers performing include:
- a. Making enquiries of personnel at the firm, for example the senior manager allocated overall responsibility for the firm's compliance with CASS.
  - b. Observing the application of controls.
  - c. Inspecting documents and reports, for example computer-generated error reports, client agreements, acknowledgement letters and custody agreements.
  - d. Testing internal and external reconciliations.
94. **The CASS auditor shall report on the adequacy of the systems throughout the period under review. This requirement does not mean that the CASS auditor has to perform tests continuously throughout the period, but bases the extent and nature of its procedures to test the effectiveness of operation of control activities on its:**
- a. **risk assessment, including its evaluation of the control environment; and**
  - b. **evaluation of the design of the system of internal control.**

*Selecting items for testing to obtain evidence of operation of controls*

95. **When designing tests of controls the CASS auditor shall apply judgment to determine the means of selecting items for testing that are effective in meeting the purpose of the assurance procedure. In doing so the CASS auditor shall be directed by their assessment of the risk of a breach of the CASS rules, and the need to gather sufficient, appropriate audit evidence to support the required reporting to the FCA and to those charged with governance,**
96. **When evaluating the effectiveness of the operation of controls, the auditor shall evaluate whether breaches that have been identified indicate that controls are or were not operating effectively.**
97. A breach may indicate the existence of a significant deficiency in internal control. The concept of effectiveness of the operation of controls recognises that some deviations in the way controls are applied by the firm may occur. Deviations from prescribed controls may be caused by such factors as changes in key personnel, fluctuations in volume of transactions and human error. The detected rate of deviation may indicate that the control cannot be relied on to sufficiently reduce the risk of breaches of the CASS rules.
98. A firm's systems and controls over client assets may be quite different to the systems and controls that it has over its own assets. Where that is the case, it would be inappropriate to draw conclusions about the design and operating effectiveness of internal controls over client assets based on evaluations of the firm's systems and controls over its own assets. However, where there are common systems, controls or governance (for example

over core systems), the CASS auditor may consider it appropriate to use this information to inform the CASS audit.

99. The CASS rules require such records of client money and custody assets to be kept as are necessary to enable the firm "at any time and without delay" to distinguish client assets held for one client from client assets held for any other client and from its own assets. CASS auditors need to be aware of the risk that firms may have different systems in place at different times of the day (for example overnight deposit arrangements) or that a firm may have transferred client assets to another legal entity. The scope of their testing should address all the systems that may be applicable to client assets at all times.

#### *Use of Third-Party Administrators*

100. When a firm enters into an arrangement with a Third Party Administrator (TPA) to outsource the operation of certain functions, such as fund administration, that are relevant to the firm's compliance with CASS rules, whether the firm retains full regulatory responsibility for compliance with CASS rules depends on the nature of the arrangements entered into between the firm, the TPA and the firm's clients. The firm retains full regulatory responsibility where the TPA simply owes contractual obligations to the firm to perform certain specified services and the TPA does not have a direct contractual relationship with the firm's clients.

101. An example of an arrangement where the firm retains full regulatory responsibility is an agreement entered into by a stockbroker to outsource clearing and settlement activities to another firm, without any change in the firm's arrangements with its clients. As settlement agent, the other firm undertakes an administrative role in the settlement of trades under a service level agreement. However, the stockbroker remains responsible for compliance with the relevant FCA rules, including CASS. In this type of arrangement, the outsourced functions support the firm's compliance with CASS. Such an arrangement is described as a 'Model A Arrangement' in some parts of the stockbroking industry. Another common example of such an arrangement is where a fund management firm outsources certain functions related to fund administration to a TPA (which may or may not be an authorised firm) without any change in the firm's arrangements with its clients.

102. Alternatively, the firm and its TPA may agree to an arrangement in which the TPA takes direct responsibility for compliance with some or all of the provisions in CASS, which is referred to in some parts of the stockbroking industry as a 'Model B Arrangement'. For example, Model B is where a second firm takes responsibility for the stockbrokers' clearing and settlement activities, often called "give up broking". In such a scenario, the second firm is responsible for compliance with the FCA's rules (including the CASS Rules) insofar as they apply to clearing and settlement processes that are the subject of the arrangement.

103. The TPA can only assume such responsibility, if it is authorised by the FCA to conduct investment business and has the requisite permission from the FCA to hold or control the client money and/or custody assets in question. Such a transfer of responsibility only

occurs if the firm's clients enter into terms of business with the TPA to establish that the TPA will be directly responsible to the client under CASS for protecting the clients' money or assets. In order to do so, the firm, the TPA and the client may enter into a tri-partite agreement that reflects the terms of business between both firms and the client. Alternatively, the firm and the TPA may each enter into separate agreements with the client to achieve this.

104. Although Model A and Model B arrangements may each be described as involving TPAs, the regulatory obligations of the firm and the TPA are different under each model and so, their impact on the scope of a CASS auditor's procedures is quite different. The actual arrangements entered into by firms can be extremely complex and members of a CASS engagement team need to have a thorough understanding both of the arrangements with the TPA and the firm's clients and of the firm's business model, particularly of the cash and other asset inflows and outflows as they apply both to the firm and to the TPA. This understanding provides a basis for establishing the respective regulatory responsibilities of the firm and (if any) the TPA for client assets and, therefore, expectations about the existence or otherwise of client assets in the context of the engagement.

**105. The CASS engagement team shall obtain an understanding of:**

- a. the firm's arrangements with the TPA and its clients; and**
- b. the firm's business model, particularly the cash and other asset inflows and outflows as they apply both to the firm and to the TPA.**

**Such an understanding provides a basis for establishing the respective regulatory responsibilities of the firm and (if any) the TPA for client assets and, therefore, expectations about the existence or otherwise of client assets in the context of the engagement.**

**106. When planning assurance procedures for a firm that has outsourced services to a TPA, the CASS auditor shall confirm the relative responsibilities of the firm and the TPA for compliance with CASS through discussions with management and review of relevant documentation including client agreements, the clients' terms of business (if any) with the TPA and the firm's agreement with the TPA. The CASS auditor also establishes whether the scope of the firm's and, where applicable, the TPA's permissions from the FCA include the holding of client money and/or custody assets. The CASS auditor shall also consider, when planning their assurance procedures, all necessary information available to the auditor to assess the adequacy and effectiveness of governance, operations and control in place at the TPA as they apply to the CASS activities that the TPA performs for the firm.**

107. Assurance procedures are designed in a way that treats the TPA as, in effect, an integral part of the firm. In support of this approach SUP 3.6.1R and SUP 3.6.7G require the firm to ensure that the auditor has access to books, accounts and vouchers of the firm held by its TPA and has the co-operation of the TPA.

**108. The CASS auditor shall plan to perform assurance procedures that cover outsourced functions for which the firm retains responsibility for client assets under the CASS rules. This may include the provision of System and Organisation Control (SOC) Reports, attesting to the adequacy of operating controls in place within the outsourced body. Where the CASS auditor assesses that the work is sufficiently detailed and places reliance on such reports, it shall assess the independence, skills, capacity and quality of work undertaken by the provider of the SOC Report, and document its assessment and conclusions drawn in the audit file, having taken account of the auditor's own assessment required by paragraph 106 of this Standard.**

**109. The CASS auditor's engagement letter shall stipulate that the contractual arrangements between the firm and the TPA should provide for the CASS auditor to have rights of access to the TPA's books and records and to employees of the TPA responsible for operating relevant processes on behalf of the firm. The CASS auditor shall consider its position where such provisions are not in force between the firm and the TPA.**

110. In considering its position the CASS auditor may wish to discuss the matter with the FCA and determine an appropriate course of action such as agreeing a lesser scope of work.

### **Obtaining evidence to support the opinion as to whether the firm was in compliance with relevant CASS rules at the end of the period**

**111. The CASS auditor shall evaluate the firm's compliance with each relevant CASS rule at the period end date.**

112. The nature and extent of the CASS auditor's testing procedures will be a function of the conclusions it has formed on the effectiveness of internal control and the specific nature of the applicable CASS rules. Relevant considerations may include:

- Where applicable, examining the contractual terms between the firm and third parties such as administrators (see paragraphs 100 to 110);
- Testing internal and external reconciliations at the period end date and evaluating whether explanations of reconciling items are legitimate;
- Obtaining external confirmation letters, such as bank confirmations and custodian confirmations; and
- Checking whether client bank account acknowledgement letters have been obtained by the firm and are in force as at the period end.

### **Forming the Client Assets Opinion**

**113. The CASS auditor shall evaluate the sufficiency and appropriateness of the evidence obtained in the context of the engagement and, if necessary, perform procedures to obtain further evidence. The CASS auditor shall consider all relevant evidence, both corroborative and contradictory, to determine whether the firm:**

- a. has maintained systems adequate to enable it to comply with the relevant CASS rules throughout the period; and
- b. was in compliance with relevant CASS rules at the end of the period.

If the CASS auditor is unable to obtain necessary further evidence, the CASS auditor considers the implications for its opinions.

*The interrelationship between the forming of the opinion and the reporting of breaches*

114. The CASS auditor shall express unmodified opinions in a reasonable assurance report on client assets when as a result of performing its assurance procedures it has formed the opinion that the firm has both maintained systems adequate to comply with the relevant CASS rules throughout the period and was in compliance with relevant CASS rules at the end of the period. The process for forming these opinions is depicted in Appendix 1 and an unmodified opinion is illustrated in Appendix 4.
115. The CASS auditor is required to report all breaches identified by it or identified to it by any other party including the firm. Although a breach may be of minor significance, this is not a relevant consideration when determining if a CASS rule has been breached. The reporting of any breach of a CASS rules shall result in the CASS auditor expressing a modified opinion regarding the adequacy of systems during the period. The reporting of breaches may also result in the need for the CASS auditor to express a modified opinion regarding compliance with the CASS rules at the period-end date. In forming their opinion, the CASS auditor considers the impact of all identified breaches, and the effect they would have on the effective operation of the CASS regime as required by the CASS rules.
116. The FCA's report template includes a breaches schedule that is required to be completed by the CASS auditor in order to report all identified breaches of CASS rules by the firm, of which the CASS auditor becomes aware, occurring during the period subject to the Client Assets Report. The breaches reported shall include all the breaches the CASS auditor has become aware of either through its work or through disclosure to it by the firm or any other party.
117. The CASS auditor is not engaged to provide absolute assurance that all breaches committed by the firm are included in the breaches schedule. Where no breaches have been identified by, or disclosed to it, the CASS auditor provides a nil return. This is illustrated in Appendix 4.
118. The CASS auditor shall obtain a written representation from management of the firm that to the best of their knowledge and belief, either the list of breaches is complete or there have been no breaches identified.
119. If breaches arose during the period and were identified by or reported to the CASS auditor, but all have been rectified by the period end the CASS auditor shall issue a

**modified opinion as to the maintenance of adequate systems throughout the period and an unmodified opinion on compliance with the CASS Rules at the period end. This is illustrated in Appendix 2.**

120. An absence of breaches may not preclude the need for a modified opinion on the adequacy of systems. A firm could have inadequate systems but through a combination of circumstances have avoided any reportable breaches; however, the requirements within CASS 6.2 and CASS 7.12 require firms to have adequate arrangements, organisational arrangements and robust systems in place. Similarly, the reporting of a specific breach does not necessarily mean that the systems are adequate in all other respects.
- 121. Where the CASS auditor determines that a modified opinion is required it shall determine whether to issue an “except for” or an “adverse” opinion in accordance with the requirements and guidance in the FCA’s SUP rules.**
122. SUP 3.10.9C (2) G provides the following guidance: “For the purpose of determining whether to qualify its opinion or express an adverse opinion, the FCA would expect an auditor to exercise its professional judgment as to the significance of a rule breach, as well as to its context, duration and incidence of repetition. The FCA would expect an auditor to consider the aggregate effect of any breaches when judging whether a firm had failed to comply with the requirements described in SUP 3.10.5R (1) to (4)”.
123. The principle underlying the need for an adverse opinion arises from the CASS auditor concluding that identified weaknesses in control and/or breaches of rules are systemic, or pervasive (and therefore likely to give rise to fundamental issues of control), as opposed to isolated incidents.
124. A practical starting point, when deciding between an “except for” or “adverse” opinion, is for the CASS auditor to consider whether the rule breaches indicate that there has been a systemic or pervasive failure to comply with the principle of protecting client assets. If the firm’s system design is significantly flawed or repeatedly fails, an adverse opinion is likely to be appropriate. If the system generally works but there have been isolated breaches, an “except for” opinion is likely to be appropriate.
125. Particular areas the CASS auditor considers which might give rise to an adverse opinion include:
- The extent to which clients might have lost their assets/money if the firm had gone into administration while the breach persisted.
  - Whether there had been a breach of the requirement to keep proper records of client assets.
  - Whether the firm had failed to carry out, or incorrectly carried out to a significant extent, the reconciliations required by the CASS rules.



## Content of a Reasonable Assurance Client Assets Report

126. A reasonable assurance Client Assets Report shall include the following elements:

- a. A title that;
  - i. clearly indicates the report is an independent reasonable assurance report;
  - ii. addresses the report to the Financial Conduct Authority<sup>12</sup>.
  - iii. states the name of the firm and its FCA Reference number.
- b. Introductory paragraphs that:
  - i. specify the start and end date of the period being reported on;
  - ii. state that the report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.
- c. A description of the basis of opinion which shall state, where it is the case, that:
  - i. the CASS auditor has carried out all relevant procedures specified by this Standard;
  - ii. the opinions relate only to the period, or as at the date, specified;
  - iii. the opinions do not provide assurance in relation to any future period or date as changes to systems or controls subsequent to the date of this report may alter the validity of the opinions.
- d. An expression of opinion as to whether the firm maintained systems adequate to enable it to comply with the custody rules, collateral rules, mandate rules, client money rules, rules relating to nominee companies and secondary pooling events throughout the period since the last date at which a report was made.
- e. An expression of opinion as to whether the firm was in compliance with the custody rules, collateral rules, mandate rules, client money rules, rules relating to nominee companies and secondary pooling events as at the period end date.
- f. Where required by SUP 3.10.5R(3), an expression of an opinion as to whether the firm's nominee companies that are subsidiaries of the firm, and in whose name custody assets are registered, have maintained throughout the period systems for the custody, identification and control of custody assets which a) where adequate; and b) included reconciliations at appropriate intervals between the records maintained (whether by the firm or the nominee company) and statements of confirmations from custodians or from the person who maintained the record of legal entitlement.
- g. Where required by SUP 3.10.5R(4), a statement as to whether the firm has complied with the rules in CASS 5.6 and CASS 7A (client money distribution) and CASS 11.13 (debt management client money distribution rules) in relation to that pooling event.
- h. A statement that the report should be read in conjunction with the Breaches Schedule that the CASS auditor has prepared.

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12 In the case of Insurance Intermediaries, the FCA's rules require the report to be submitted to 'the firm'.

- i. The CASS engagement leader's signature and the name of the CASS auditor's firm.
- j. The date of the Client Assets Report.
- k. The location in the jurisdiction where the CASS auditor practices.
- l. A Breaches Schedule prepared in accordance with paragraphs 127 to 130 of this Standard.

The FCA Handbook at <https://www.handbook.fca.org.uk/> contains the extant version of the FCA's rules listing the requirements for the reasonable assurance report, and should be consulted before the report is prepared.

#### *Detailed reporting of Breaches*

**127. In columns A to D of the breaches schedule the CASS auditor shall set out those breaches of CASS by the firm, of which it has become aware, occurring during the period covered by the Client Assets Report. The sources of the breaches reported shall include:**

- a. Those breaches the CASS auditor has identified through its own work (such as in the testing of reconciliations);
- b. Those breaches identified by the firm (such as those included in the firm's breaches register); and
- c. Breaches identified by and disclosed to the CASS auditor by any other party including the FCA

**128. In column D of the Breaches Schedule the CASS auditor shall provide any information that it has in respect of the severity and duration of the breach identified and, where relevant, the frequency with which that breach has occurred.**

**129. Where no CASS rule breaches have been identified the CASS auditor shall provide a nil return.**

**130. In column E of the breaches schedule the firm is required to set out any remedial actions taken (if any) associated with the breaches cited, together with an explanation of the circumstances that gave rise to the breach in question. The FCA explicitly states in SUP 3 Annex 1R that the CASS auditor has no responsibility for the content of column E. Nevertheless, where the CASS auditor is aware that the comments provided by the firm in the CASS auditor's report in relation to the identified breaches are inaccurate or false, the CASS auditor remains subject to FSMA 2000 reporting requirements and its profession's ethical rules and standards.**

#### *Expressing a qualified opinion*

**131. If the CASS auditor expresses a qualified opinion as a result of breaches of the CASS rules (i.e. states "that except for ..., the firm maintained" or "that except for ..., the firm was in compliance ...") it shall do so by reference to items in columns A to D**

in the Breaches Schedule, and should be cross referenced to the Schedule. This is illustrated in Appendix 2.

*Expressing an adverse opinion*

**132. If the CASS auditor expresses an adverse opinion (i.e. states the firm “did not maintain...” or “was not in compliance ...”) it shall set out the reasons in the Client Assets Report. This can be done by reference to items in columns A to D in the Breaches Schedule appended to the Client Assets Report and should be cross referenced to that Schedule. This is illustrated in Appendix 3.**

*Inability to form an opinion*

**133. If the CASS auditor is unable to obtain sufficient, appropriate assurance evidence to enable it to form an opinion as to whether one or more of the applicable requirements set out in SUP 3.10.5R have been met, the CASS auditor shall specify in its report those requirements and the reasons why the auditor has been unable to form an opinion.**

**Communicating deficiencies in internal control to management and those charged with governance**

134. During the CASS audit the CASS auditor may identify deficiencies in internal control that whilst not significant may be of sufficient importance to merit management’s attention because the deficiencies may give rise to reportable breaches of the CASS Rules in future periods. Communicating deficiencies in internal control to management and those charged with governance does not remove the requirement to report to the FCA, where appropriate, deficiencies affecting the adequacy of the firm’s systems, notwithstanding that a rule has not been breached.

**135. The CASS auditor shall communicate to management and those charged with governance on a timely basis, deficiencies in internal control arising from the audit that, in the CASS auditor’s professional judgment, 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 judgment, pose the most significant risk of non-compliance with the CASS rules, and which require the most urgent resolution. This does not extend to reporting deficiencies, where in the auditor’s professional judgment, the matter has been adequately addressed by the wording of a reporting breach and the management response on that breach.**

136. Communicating significant deficiencies in writing to those charged with governance reflects the importance of these matters and assists those charged with governance in fulfilling their oversight responsibilities.

**Engagement Quality Control Review**

**137. As the effective segregation of client assets is in the public interest, an audit firm’s system of engagement quality control reviews shall encompass all such**

engagements that provide reasonable assurance to the FCA on client assets, for CASS investment business firms, which meet the FCA's classification as Large or Medium. For Small CASS firms, the CASS auditor shall use professional judgment, considering factors such as the complexity of the entity's business, the risk of breaches of the CASS regime. The CASS auditor shall consult with the audit firm's compliance and quality function, to determine those circumstances where an engagement quality control review should be conducted. For non-classified businesses, the auditor should apply the classifications in CASS 1A2.7R to determine those engagements that require an engagement quality control review. For those that do not, the CASS auditor shall use their professional judgment to identify engagements which would benefit from an engagement quality control review. For all CASS engagements, the CASS auditor shall document on file the basis for their assessment and their conclusion on whether an engagement quality control review is required.

138. An important feature of a system of quality control is the Engagement Quality Control Review which is "A process designed to provide an objective evaluation, on or before the date of the report, of:

- a. the significant judgments made by the CASS engagement team; and
- b. the conclusions reached in formulating the report".

139. With respect to Engagement Quality Control reviews of all CASS reasonable assurance engagements for Large and Medium CASS investment business firms, and other CASS engagements meeting the criteria in paragraph 137 of this Standard:

- a. The CASS engagement leader shall take responsibility for discussing significant matters arising during the engagement with the engagement quality control reviewer, and not issue or date the assurance report until completion of that review; and
- b. The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the assurance opinion. This evaluation shall involve:
  - i. Discussion of significant matters (including those arising at the planning stage of the engagement) with the engagement leader;
  - ii. Reviewing the outcome of the evaluation of the adequacy of the firm's systems during the period and its compliance with applicable CASS rules at the period end date and the proposed assurance opinion, including the breaches schedule;
  - iii. Review of selected engagement documentation relating to the significant judgments the engagement team made and the conclusions it reached; and
  - iv. Evaluation of the conclusions reached in formulating the assurance opinion and consideration of whether the proposed assurance report is appropriate.

140. Other matters that may be considered in an engagement quality control review include:

- The CASS engagement team's evaluation of the firm's independence in relation to the engagement.
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
- Whether engagement documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.

**141. If differences of opinion arise:**

- a. Within the CASS engagement team;**
- b. With those consulted; or**
- c. Between the CASS engagement leader and the engagement quality control reviewer**

**the engagement team shall follow the CASS auditor's firm's policies and procedures for dealing with and resolving differences of opinion.**

## **REQUIREMENTS APPLICABLE TO THE EXPRESSION OF LIMITED ASSURANCE OPINIONS WHERE A FIRM CLAIMS NOT TO HOLD CLIENT ASSETS**

*The requirements and guidance in paragraphs 11 to 66 also apply to the expression of limited assurance opinions where a firm has relevant permissions but claims not to hold client assets and where a firm does not have relevant permissions.*

### **Circumstances giving rise to limited assurance opinions**

142. The table in SUP 3.1.2R sets out, among other things, those firms to whom SUP 3.10 “Duties of auditors: notification and report on client assets” applies. Under SUP 3.10.4R where a firm “claims” not to hold client money or custody assets its auditor must submit a Client Assets Report stating whether anything has come to the auditor’s attention that causes him to believe that the firm held client money or custody assets during the period covered by the report. (N.B. The FCA rules do not require limited assurance opinions in respect of insurance intermediaries and certain other categories of firms).
143. For the purposes of this Standard the term “claims” is deemed to apply in two circumstances:
- a. Where the scope of the firm’s permissions does not include the holding of client money and/or custody assets; and
  - b. Where the scope of the firm’s permissions does include the holding of client money and/or custody assets, but the firm claims not to hold them.
144. SUP 3.1.1R applies Chapter 3 of SUP to external auditors of firms whether specifically appointed under SUP 3.3 or under, or as a result of, a statutory provision other than in FSMA 2000 (an example would be an appointment as auditor under the Companies Act 2006). An auditor appointed under, for example, CA 2006 is, therefore, responsible for submitting a Client Assets Report to the FCA notwithstanding that they may not have been formally appointed as a CASS auditor.

### **Limited Assurance Client Assets Reports where a firm has permission to hold client money and/or custody assets, but management claims it does not hold either client money or custody assets**

145. **The CASS auditor shall obtain an understanding from the firm as to the reasons why the firm has the relevant permission but has not actually held client money or custody assets.**
146. **The CASS auditor shall review the CASS-related notifications submitted to the FCA that relate to the period under review and ascertain whether they report that no client money or custody assets were held.**
147. **The CASS auditor shall review the conclusions reached when performing the procedures set out in paragraph 11 and shall also evaluate whether effective**

**controls exist within the firm to enable it to identify the existence of client money and/or custody assets, and/or whether the firm is entitled to rely on any exemptions from the CASS rules in relation to any money or assets held<sup>13</sup>, and if so whether they are appropriately designed and implemented. Such a system might constitute periodic review by internal audit or the compliance function and encompass substantive reviews of bank accounts and client agreements.**

148. Based on this understanding the auditor performs those procedures set out in the following paragraphs which are appropriate in the circumstances.
149. **Where the CASS auditor is also the financial statements auditor and has access to the work of the financial statements auditor, the CASS auditor shall consider the results of audit procedures performed with respect to the firm's financial statements for the period corresponding, or overlapping, with the period of the client asset audit and whether evidence was found of the existence of client money or custody assets held by the firm.**
150. **The CASS auditor shall enquire as to what arrangements the firm has in place to ensure that relevant staff members are aware of what constitutes client assets. These arrangements should be adequately documented, and the documentation should be readily available to relevant staff. The documentation should outline the procedures to be followed if client assets are identified.**
151. **Where a system of internal control exists to ensure that client assets are not controlled or held, the CASS auditor shall discuss the results of its operation with those responsible for it.**
152. **The CASS auditor shall enquire of management responsible for dealing with client business, and others as appropriate, as to whether they have knowledge of any client money or custody assets held during the period.**
153. **The CASS auditor shall review the firm's breaches register or equivalent and correspondence between the firm and the FCA for evidence of the existence of client money or custody assets.**
154. **The CASS auditor shall enquire as to how settlements are effected on behalf of clients (reference shall be made to client documentation and payment instructions on contract notes or statements) and review the firm's client files to see whether they provide any indication that the firm has held client assets in order to undertake a particular transaction.**

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13 The CASS Rules contain various exemptions that dis-apply the CASS Rules. Examples relate to; Delivery versus Payment arrangements (DVP), Title Transfer Collateral Arrangements, risk transfer and the banking exemption.

155. The CASS auditor shall review a sample of client agreements for statements of how custody of assets and monies is to be operated and as a corollary, review the agreements with any custodians used and the counterparty files for correspondence on settlement procedures to ensure that there is no evidence that the firm has offered client money or custody asset protection.

156. The CASS auditor shall enquire as to how dividends, especially unclaimed dividends, and rights issues are dealt with by the firm.

### **Written Representation**

157. In addition to the representations referred to in paragraph 51, the CASS auditor shall request from appropriate officials of the firm a written representation that the firm has not held any custody assets or client money during the period.

### **Forming the Limited Assurance Opinion**

158. If no evidence is found to the contrary, the CASS auditor shall provide limited assurance in the form of a negative opinion that, based on review procedures performed, nothing has come to the attention of the CASS auditor that causes it to believe that the firm held client money or custody assets during the period.

159. If based on these procedures the CASS auditor becomes aware of evidence that the firm held client money or custody assets contrary either:

- a. To the permissions it held; or
- b. To a claim that, where it has permissions, it held none,

the CASS auditor encourages the firm to promptly report the matter to the FCA. If the firm does not report the matter promptly to the FCA the CASS auditor shall promptly report the matter directly to the FCA. The CASS auditor is further required to provide a modified limited assurance report as illustrated in Appendix 8.

### **Content of a Limited Assurance Client Assets Report**

160. A limited assurance Client Assets Report shall include the following elements:

- a. A title that;
  - i. clearly indicates the report is an independent limited assurance report;
  - ii. addresses the report to the Financial Conduct Authority
  - iii. states the name of the firm and its FCA Reference number.
- b. Introductory paragraphs that:
  - i. specify the start and end date of the period being reported on;
  - ii. state that the report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.



- c. A description of the basis of opinion which shall state, where it is the case, that:
  - i. the CASS auditor has carried out such procedures set out in this Standard as it considered necessary;
  - ii. the work performed was designed to provide limited, rather than reasonable assurance;
  - iii. the opinions relate only to the period, or as at the date, specified;
  - iv. the opinions do not provide assurance in relation to any future period or date.
- d. A statement repeating the assertion of the directors of the firm that either:
  - i. The firm's permissions do not allow it to hold client money and/or custody assets; or
  - ii. The firm's permissions do allow it to hold client money and/or custody assets, but the firm did not hold client money and/or custody assets during the period.
- e. An opinion that based on review procedures performed nothing has come to the CASS auditor's attention that causes it to believe that the firm held client money or custody assets during the period.
- f. The CASS auditor's signature and the name of the CASS auditor's firm.
- g. The date of the Client Assets Report.
- h. The location in the jurisdiction where the CASS auditor practices.

**The FCA Handbook at <https://www.handbook.fca.org.uk/> contains the extant version of the FCA's rules listing the requirements for the limited assurance report and should be consulted before the report is prepared.**

161. Appendices to this Standard provide the following illustrative opinions of unmodified limited assurance Client Assets Reports:
- a. Where a firm has permission to hold both client money and custody assets and claims to hold neither (Appendix 5);
  - b. Where a firm is permitted to hold client money but not custody assets and claims to hold neither (Appendix 6);
  - c. Where a firm does not have permissions to hold client money or custody assets and claims to hold neither (Appendix 7).
162. Appendix 8 to this Standard illustrates a modified limited assurance opinion where a firm holds client money but does not have permission to do so.

## **THE EXPRESSION OF HYBRID OPINIONS**

163. Where appropriate the CASS auditor may issue hybrid opinions expressing, for example, a limited assurance opinion with respect to client money and a reasonable assurance opinion with respect to custody assets. This is illustrated in Appendix 3.

## **REQUIREMENTS APPLICABLE TO THE PROVISION OF REASONABLE ASSURANCE WITH RESPECT TO SPECIAL REPORTS**

164. The CASS rules permit certain firms to use an “alternative approach” to client money segregation and a “non-standard method” of internal client money reconciliation<sup>14</sup>. In both cases the FCA requires the firm to send a written report to the FCA prepared by an independent auditor in line with a reasonable assurance engagement setting out specific matters regarding the use of either the alternative approach or the non-standard method. This is a separate engagement to the CASS audit.
165. **The CASS auditor shall obtain an understanding of the firm’s proposed systems, internal controls and with respect to the alternative approach to client money segregation the calculation of the “mandatory prudent segregation amount” relating to a Special Report sufficient for it to be able to evaluate whether the firm’s proposed systems and controls are suitably designed to enable the firm to comply with the relevant CASS rules.**
166. **The CASS auditor shall evaluate whether the design of the firm’s systems and controls relating to a Special Report will, if implemented and operated effectively, assure compliance with the CASS rules relating to the alternative approach or non-standard method. As part of this evaluation the auditor shall consider its findings in relation to paragraphs 81 to 84 relating to the firm’s control environment and in relation to paragraphs 85 to 88 relating to the firm’s monitoring activities.**
167. **If the CASS auditor is able to obtain reasonable assurance on the matters specified by the FCA it shall prepare and submit to the firm a reasonable assurance report setting out such matters specified by the FCA. Illustrative examples of wording for such reports are set out in Appendices 9 and 10.**
168. The FCA has stated “Nothing in these [CASS] rules stipulates what steps an auditor must take to be able to provide firms with the report on the basis of a reasonable assurance engagement. We understand it is likely that many firms will need to have designed their processes and to have built test systems before an auditor feels able to provide the report”.
169. **Although the CASS rules do not require a report from the CASS auditor each year the CASS auditor shall, perform such procedures as it considers necessary each year to assess whether a Special Report remains appropriate. Specifically, the CASS auditor shall evaluate whether there have been any changes to the approach or non-standard method or to the underlying subject matter to which the alternative approach or non-standard method is being applied that would invalidate the reasonable assurance report previously provided by the CASS auditor.**

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14 In this Standard these are referred to collectively as “Special Reports”.

**170. In respect of firms that have changed from a standard approach or method to an alternative approach or non-standard method the CASS auditor shall consider whether the firm has changed to the alternative approach or non-standard method without having provided the necessary documentation and obtained the required auditor's report.**

**171. The CASS auditor shall inform the FCA if, in its opinion:**

- a. Circumstances have changed such that any previous assurance report relating to the adoption of an alternative approach or non-standard method is no longer valid; or**
- b. A firm has adopted an alternative approach or non-standard method without first obtaining a reasonable assurance report from the CASS auditor.**

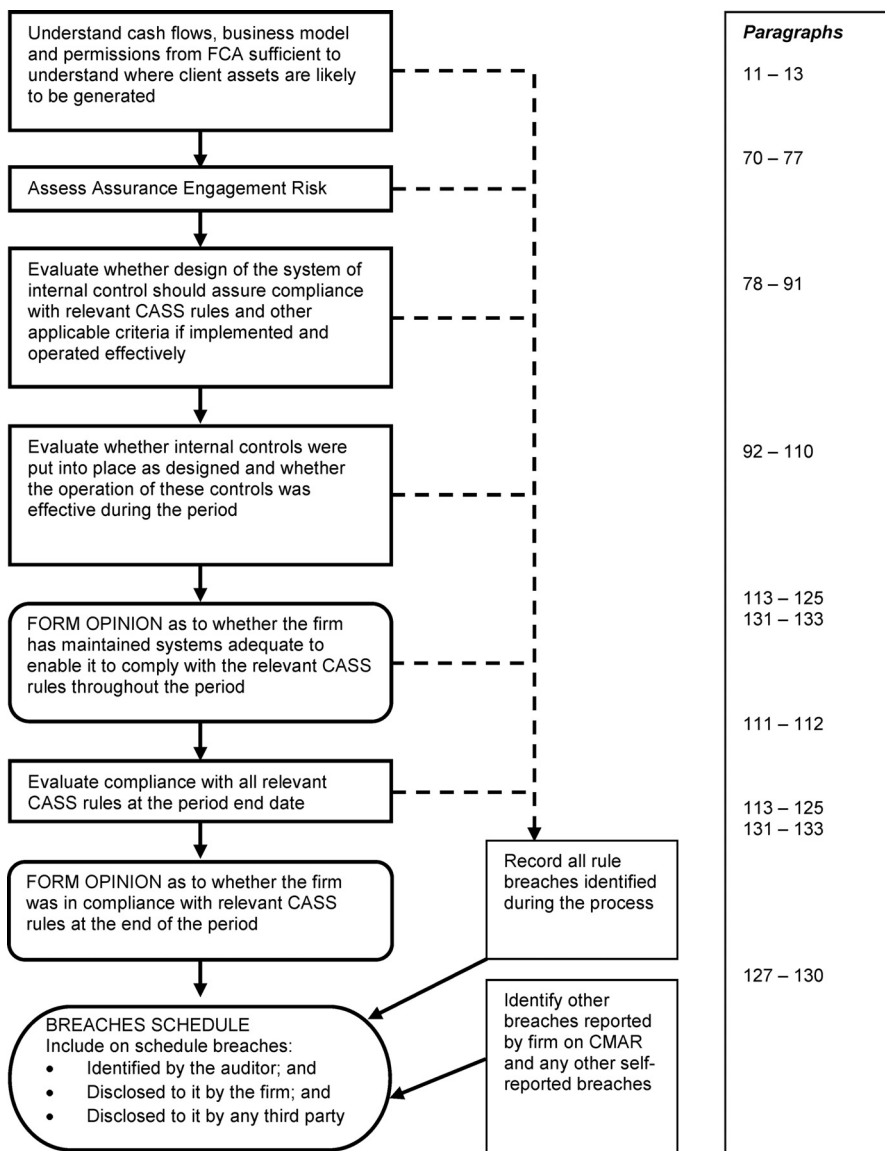
**In either case there is a breach of the CASS rules which is likely to lead to a modification of the Client Assets Report.**

## **REQUIREMENTS APPLICABLE TO CASS AUDITOR CONFIRMATIONS IN CONNECTION WITH NON-STATUTORY CLIENT MONEY TRUSTS**

172. CASS 5.4 permits an insurance intermediary firm, which has adequate resources, systems and controls, to declare a trust on terms which expressly authorise it, in its capacity as trustee, to make advances of credit to the firm's clients. The client money trust extends to such debt obligations which will arise if the insurance intermediary, as trustee, makes credit advances, to enable a client's premium obligations to be met before the premium is remitted to the firm and similarly if it does so to enable claims and premium refunds to be paid to the client before receiving remittance of those monies from the insurance undertaking.
173. CASS 5.4 does not permit a firm to make advances of credit to itself out of the client money trust.
174. An insurance intermediary may not handle client money through a non-statutory client money trust unless the firm has and maintains 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 trust arrangement. In addition, if the firm complies with both the rules relating to statutory trusts in CASS 5.3 and non-statutory trusts in CASS 5.4 such systems and controls must extend to both arrangements.
175. A condition of an insurance intermediary using a non-statutory client money trust is that it must obtain, and keep current, written confirmation from its auditor that it has in place systems and controls which are adequate to meet the requirements described in the preceding paragraph.
- 176. In order to provide the written confirmation required by CASS rule 5.4.4 (2)R the CASS auditor shall evaluate whether the firm has and maintains systems and controls over both statutory and non-statutory trusts which are adequate to ensure that the firm is able to monitor and manage its client money transactions and any credit risk that arises from the operation of such arrangements. Such an evaluation requires the CASS auditor to:**
- a. Assess assurance engagement risk relevant to the operation of trust arrangements.**
  - b. Evaluate whether the design of the system of internal control will, if implemented and operated effectively, ensure compliance with the CASS rules that are applicable to non-statutory trusts of insurance intermediaries.**
  - c. Perform, on a sample basis, walk through procedures as a means of establishing that controls have been put into place as designed.**
177. In performing the evaluation described above the CASS auditor shall evaluate the insurance intermediary's compliance with other applicable CASS requirements such as those relating to the requirements for the insurance intermediary to:

- a. designate a manager to oversee the firm's day to day compliance with the systems and controls and applicable rules. The CASS auditor's procedures shall include meeting with the designated manager and discussing that manager's authority, scope of work and findings;**
- b. maintain the minimum level of capital resources stipulated by the CASS rules;**
- c. obtain the client's informed consent to the firm holding the client's money in a non-statutory trust; and**
- d. take reasonable steps to ensure that its terms of business adequately explain the implications to a client of its money being held in a non-statutory trust.**

## OVERVIEW OF A REASONABLE ASSURANCE PROCESS FOR A LEGAL ENTITY



## ILLUSTRATIVE QUALIFIED OPINION IN A REASONABLE ASSURANCE REPORT ON CLIENT ASSETS

- The CASS auditor has determined that breaches identified on the breaches schedule do not provide evidence of systemic weaknesses in the system of internal control and that therefore its opinion on the maintenance of systems during the period should be qualified in “except for” terms. This breach was corrected before the period end.
- The firm did not have nominee companies at any time throughout the period.
- There have been no secondary pooling events during the period.

## REASONABLE ASSURANCE REPORT ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]

### Part 1: Auditor’s Opinion on Client Assets

We report in respect of [Firm name] (“the firm”) on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] (“the period”).

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority (“the FCA”) in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

#### Basis of opinions

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date as changes to systems or controls subsequent to the date of this report may alter the validity of our opinions.

#### Qualified opinion on adequacy of systems during the period

In our opinion, except for the failure of the firm to perform a reconciliation of ... in March 20xx, as described in item 1 of the attached breaches schedule, the firm has maintained systems adequate to enable it to comply with the custody rules, collateral rules, mandate rules and client money rules throughout the period since the last date at which a report was made.

#### Unmodified opinion on compliance at period end date

In our opinion, the firm was in compliance with the custody rules, collateral rules, the mandate rules and the client money rules as at the period end date.



## Other matters

This report should be read in conjunction with the Breaches Schedule that we have prepared, and which is appended.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*

## Part 2: Identified CASS Breaches that have occurred during the period BREACHES SCHEDULE

*[Firm name]*, FCA reference number *[number]*, for the period started *[dd/mm/yyyy]* and ended *[dd/mm/yyyy]*

In accordance with SUP 3.10.9AR, Columns A to D have been completed by and are the responsibility of the auditor. In accordance with SUP 3.11.1G, Column E has been completed by the firm. The auditor has no responsibility for the content of Column E.

Column A	Column B	Column C	Column D	Column E
Item No.	Rule Reference(s)	Identifying Party	Breach identified	Firm's comment
1 <i>(illustrative details to be inserted)</i>				
...				

## ILLUSTRATIVE ADVERSE OPINION IN A REASONABLE ASSURANCE REPORT ON CLIENT ASSETS

- The CASS auditor has determined that breaches identified on the breaches schedule taken together indicate systemic weakness in the control systems such that an adverse opinion is warranted in relation to client money.
- The firm claimed not to hold custody assets and the CASS auditor's work has supported this claim.
- The firm did not have nominee companies at any time throughout the period.
- There have been no secondary pooling events during the period.

### ASSURANCE REPORT<sup>15</sup> ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]

#### Part 1: Auditor's Opinion on Client Assets

We report in respect of [Firm name] ("the firm") on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] ("the period").

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority ("the FCA") in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

#### Basis of opinions

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date as changes to systems or controls subsequent to the date of this report may alter the validity of our opinions.

#### Adverse opinion on adequacy of systems during the period

In our opinion, because of the systemic failure of the firm to carry out reconciliations of ... as described in lines 1 to 5 of the attached breaches schedule the firm did not maintain systems adequate to enable it to comply with the client money rules throughout the period since the last date at which a report was made.

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<sup>15</sup> "Assurance Report" is used as the title because the report is a hybrid containing both a reasonable and a limited assurance opinion.

### **Adverse opinion on compliance at period end date**

In our opinion, because of the failure to perform the reconciliations described in lines 1 to 5 of the attached breaches schedule the firm was not in compliance with the client money rules as at the period end date.

### **Claim not to hold custody assets**

The scope of the firm's permissions did not allow it to hold custody assets.

The directors of the firm have stated that the firm did not hold custody assets during the period. Based on review procedures performed, nothing has come to our attention that causes us to believe that the firm held custody assets during the period.

### **Other matters**

This report should be read in conjunction with the Breaches Schedule that we have prepared and which is appended.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*

## **BREACHES SCHEDULE**

### **Part 2: Identified CASS Breaches that have occurred during the period**

*[Firm name]*, FCA reference number *[number]*, for the period started *[dd/mm/yyyy]* and ended *[dd/mm/yyyy]*

In accordance with SUP 3.10.9AR, Columns A to D have been completed by and are the responsibility of the auditor. In accordance with SUP 3.11.1G, Column E has been completed by the firm. The auditor has no responsibility for the content of Column E.

<b>Column A</b>	<b>Column B</b>	<b>Column C</b>	<b>Column D</b>	<b>Column E</b>
Item No.	Rule Reference(s)	Identifying Party	Breach identified	Firm's comment
1 ( <i>illustrative details to be inserted</i> )				
2				
3				
4				
5				
–				

## ILLUSTRATIVE UNMODIFIED OPINION IN A REASONABLE ASSURANCE REPORT ON CLIENT ASSETS

- Neither the CASS auditor nor the firm has identified any breaches; consequently, the breaches schedule is a nil return.
- The firm has nominee companies in whose name custody assets of the firm are registered during and at the end of the period.
- A bank, where client money had been placed, failed during the period giving rise to a secondary pooling event.

### REASONABLE ASSURANCE REPORT ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]

#### Part 1: Auditor's Opinion on Client Assets

We report in respect of [Firm name] ("the firm") on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] ("the period").

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority ("the FCA") in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

#### Basis of opinions

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date as changes to systems or controls subsequent to the date of this report may alter the validity of our opinions.

#### Unmodified opinions on adequacy of systems during the period

In our opinion, the firm has maintained systems adequate to enable it to comply with the custody rules, collateral rules, mandate rules and client money rules throughout the period since the last date at which a report was made.

In our opinion [name of nominee companies], subsidiaries of the firm which are nominee companies during the period in whose name custody assets are registered, have maintained throughout the period systems for the custody, identification and control of custody assets which:

- a. were adequate; and
- b. included reconciliations at appropriate intervals between the records maintained (whether by the firm or the nominee company) and statements or confirmations from custodians or from the person who maintained the record of legal entitlement.

**Unmodified opinion on compliance at period end date**

In our opinion, the firm was in compliance with the [custody rules,] [collateral rules,] [the mandate rules] [and] [the client money rules] as at the period end date.

**Unmodified opinion on secondary pooling event**

In our opinion, in relation to the secondary pooling event during the period, the firm has complied with the rules in [CASS 5.6] [CASS 7A] and [CASS 11.13] in relation to that pooling event.

**Other matters**

Our opinion expressed above does not extend to the appended Breaches Schedule.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*

**BREACHES SCHEDULE**

**Part 2: Identified CASS Breaches that have occurred during the period**

*[Firm name]*, FCA reference number *[number]*, for the period started *[dd/mm/yyyy]* and ended *[dd/mm/yyyy]*

In accordance with SUP 3.10.9AR, Columns A to D have been completed by and are the responsibility of the auditor. In accordance with SUP 3.11.1G, Column E has been completed by the firm. The auditor has no responsibility for the content of Column E.

<b>Column A</b>	<b>Column B</b>	<b>Column C</b>	<b>Column D</b>	<b>Column E</b>
Item No.	Rule Reference(s)	Identifying Party	Breach identified	Firm's comment
			<b>NO BREACHES WERE IDENTIFIED</b>	
...				

## ILLUSTRATIVE UNMODIFIED OPINION IN A LIMITED ASSURANCE REPORT ON CLIENT ASSETS WHERE FIRM HAS PERMISSION TO HOLD BOTH CLIENT MONEY AND CUSTODY ASSETS BUT CLAIMS TO HOLD NEITHER

- The scope of the firm's permissions allows it to hold client money and custody assets, but the firm claims not to hold either of them.

### LIMITED ASSURANCE REPORT ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]

We report in respect of [Firm name] ("the firm") on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] ("the period").

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority ("the FCA") in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

#### Basis of opinion

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date.

#### Unmodified opinion

The directors of the firm have stated that the firm did not hold client money or custody assets during the period. Based on review procedures performed, nothing has come to our attention that causes us to believe that the firm held client money or custody assets during the period.

[Signature]

John Smith for and on behalf of [Name of audit firm]

Address

Date

## ILLUSTRATIVE UNMODIFIED OPINION IN A LIMITED ASSURANCE REPORT ON CLIENT ASSETS WHERE THE FIRM IS PERMITTED TO HOLD CLIENT MONEY BUT NOT CUSTODY ASSETS AND CLAIMS TO HOLD NEITHER

- The scope of the firm's permissions allows it to hold client money but not custody assets. The firm claims to hold neither client money nor custody assets.

### LIMITED ASSURANCE REPORT ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]

We report in respect of [Firm name] ("the firm") on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] ("the period").

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority ("the FCA") in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

#### **Basis of opinion**

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date.

#### **Unmodified opinion**

The scope of the firm's permissions did not allow it to hold custody assets.

The directors of the firm have stated that the firm did not hold client money or custody assets during the period. Based on review procedures performed, nothing has come to our attention that causes us to believe that the firm held client money or custody assets during the period.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*

**ILLUSTRATIVE UNMODIFIED OPINION IN A LIMITED ASSURANCE REPORT ON CLIENT ASSETS WHERE THE FIRM DOES NOT HAVE PERMISSION TO HOLD CLIENT MONEY OR CUSTODY ASSETS AND CLAIMS TO HOLD NEITHER**

- The firm does not have permissions to hold client money or custody assets and the firm claims to hold neither of them.

**LIMITED ASSURANCE REPORT ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]**

We report in respect of [Firm name] (“the firm”) on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] (“the period”).

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority (“the FCA”) in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

**Basis of opinion**

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date.

**Unmodified opinion**

The scope of the firm’s permissions did not allow it to hold client money or custody assets.

The directors of the firm have stated that the firm did not hold client money or custody assets during the period. Based on review procedures performed, nothing has come to our attention that causes us to believe that the firm held client money or custody assets during the period.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*



## ILLUSTRATIVE MODIFIED LIMITED ASSURANCE OPINION ON CLIENT ASSETS WHERE A FIRM HOLDS CLIENT MONEY BUT DOES NOT HAVE PERMISSION TO DO SO

- The scope of the firm's permissions allows it to hold custody assets but not client money. The firm claims to hold neither custody assets nor client money.

### LIMITED ASSURANCE REPORT ON CLIENT ASSETS BY THE INDEPENDENT AUDITOR TO THE FINANCIAL CONDUCT AUTHORITY IN RESPECT OF [NAME OF FIRM], FCA REFERENCE NUMBER [NUMBER]

We report in respect of [Firm name] ("the firm") on the matters set out below for the period started [dd/mm/yyyy] and ended [dd/mm/yyyy] ("the period").

Our report has been prepared as required by SUP 3.10.4R and is addressed to the Financial Conduct Authority ("the FCA") in its capacity as regulator of financial services firms under the Financial Services and Markets Act 2000.

#### Basis of opinion

We have carried out such procedures as we considered necessary for the purposes of this report in accordance with the Client Asset Assurance Standard issued by the Financial Reporting Council.

The opinions relate only to the period, or as at the date, specified. The opinions do not provide assurance in relation to any future period or date.

#### Modified opinion on client money

The scope of the firm's permissions allowed it to hold custody assets but not to hold client money.

The directors (or equivalent corporate officers) of the firm have stated that the firm did not hold client money or custody assets during the period. Arising from the findings of our review procedures it came to our attention that, contrary to its permissions, the firm held client money [include information about how much client money is involved and the circumstances leading to the firm holding such client money] during [specify period during which client money was held].

#### Unmodified opinion on custody assets

Based on review procedures performed, nothing has come to our attention that causes us to believe that the firm held custody assets during the period.

*[Signature]*  
John Smith for and on behalf of [Name of audit firm]

*Address*  
*Date*

## THE ALTERNATIVE APPROACH TO CLIENT MONEY SEGREGATION

### Normal approach to client money segregation

1. Under the so-called normal approach, a firm must promptly, and in any event no later than the next business day after receipt, deposit all client money into a segregated client account with a third party bank. This may be either a general client account where client monies are pooled or a designated client account where the client money from one or more clients is deposited to the exclusion of other clients. Notifications are required as a matter of regulation to be made to the third party bank to make it aware that the account is a trust account, and waivers must be obtained from the bank so as to prevent set-off against monies held on behalf of the institution itself.

### Alternative approach to client money segregation relating to investment businesses

2. Under the alternative approach, client money is received into and paid out of a firm's own bank account. The firm is then required to carry out end-of-day reconciliations to determine the daily client money requirement (i.e. the total amount of money that constitutes client money required to be segregated). The firm must then immediately reconcile the client money account with the requisite amount. Intra-day the client money account must contain a buffer (now described as a mandatory prudent segregation amount) in an effort to ensure adequate monies are segregated on clients' behalves in case of insolvency.
3. A firm that adopts the alternative approach to segregating client money should (if it follows the standard method of client money reconciliation) carry out an internal client money reconciliation on each business day and calculate how much money it either needs to withdraw from, or place in from its own bank account or its client bank account as a result of any discrepancy arising between its client money requirement and its client money resource as at the close of business on the previous business day.
4. The alternative approach is designed to address the risks that:
  - a. Client money in a firm's own bank account may not be available to be pooled for distribution to clients on the occurrence of a primary pooling event; and
  - b. At the time of a primary pooling event the firm may not have segregated in its client bank account a sufficient amount of client money to meet its client money requirement.
5. Firms that already use the alternative approach to client money segregation and those firms wishing to use it in future will need to establish and document their reasons for using the alternative approach for a particular business line.

6. Before adopting the alternative approach, a firm must send a written report to the FCA prepared by an independent auditor of the firm in line with a reasonable assurance engagement stating whether in the auditor's opinion:
  - a. the firm's systems and controls are suitably designed to enable it to comply with CASS 7.13.62R to CASS 7.13.65R; and
  - b. the firm's calculation of its alternative approach mandatory prudent segregation amount (buffer) under CASS 7.13.65R is suitably designed to enable the firm to comply with CASS 7.13.65R.

7. The FCA in PS14/9 state:

"The report will be prepared on the basis of a reasonable assurance engagement. We understand this is achievable under the FRC's definition of a reasonable assurance engagement. Nothing in these rules stipulates what steps an auditor must take to be able to provide firms with the report on the basis of a reasonable assurance engagement. We understand it is likely that many firms will need to have designed their processes and to have built test systems before an auditor feels able to provide the report. However, the specific steps an auditor may need to follow, and the matters which a firm may need to address before the auditor issues a reasonable assurance report, are matters for the auditor's professional judgment as governed by the requirements and standards imposed on the auditor by its regulator."

8. An illustrative example of such a report is set out below.

### **REASONABLE ASSURANCE REPORT TO XYZ PLC ON ITS PROPOSED USE OF THE ALTERNATIVE APPROACH TO CLIENT MONEY SEGREGATION**

You have informed us that you intend to adopt the alternative approach to client money segregation and send to the Financial Conduct Authority (FCA) a report by an independent auditor in accordance with CASS 7.13.58R. At your request, we have performed a reasonable assurance engagement on the suitability of the design of those systems, controls and calculations that relate to the adoption of the alternative approach.

#### **Respective responsibilities of firm and auditor**

The firm is responsible for designing systems, controls and calculations that enable it to comply with the relevant requirements of the CASS rules of the FCA which are applicable to the alternative approach to client money segregation. Our responsibility is to perform a reasonable assurance engagement and express an opinion on the suitability of the design of such systems, controls and calculations that management proposes to establish that will enable the firm to comply with the relevant CASS rules. Our engagement was carried out in accordance with the requirements of the Client Asset Assurance Standard issued by the Financial Reporting Council.

#### **[Inherent limitation in our engagement**

As the firm has not yet implemented the systems and controls whose design, we have evaluated we are not able to, and do not, provide any assurance as to whether:

- a. the systems, controls and calculations will be put in place as designed; or
- b. the systems and controls will operate effectively.]

## Opinion

In our opinion:

- a. the firm's systems and controls are suitably designed to enable it to comply with CASS 7.13.62R to CASS 7.13.65R; and
- b. the firm's calculation of its alternative approach mandatory prudent segregation amount under CASS 7.13.65R is suitably designed to enable the firm to comply with CASS 7.13.65R.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*

## THE NON-STANDARD METHOD OF INTERNAL CLIENT MONEY RECONCILIATION

1. The FCA defines an internal client money reconciliation as “a reconciliation between a firm’s internal records and accounts of the amount of client money held for each client with its internal records and accounts of the client money that the firm should be holding in client bank accounts or have placed in client transaction accounts”.
2. An internal client money reconciliation should:
  - a. Be one of the steps a firm takes to arrange adequate protection for client assets when the firm is responsible for them;
  - b. Be one of the steps a firm takes to satisfy its obligations under the CASS rules to ensure the accuracy of the firm’s records and accounts;
  - c. For the normal approach to segregating client money check whether the amount of client money recorded in the firm’s records as being segregated in client bank accounts meets the firm’s obligations to its clients under the client money rules on a daily basis; and
  - d. For the alternative approach to segregating client money calculate the amount of client money to be segregated in client bank accounts which meets the firm’s obligations to its clients under the client money rules on a daily basis.
3. A firm is required to perform an internal client money reconciliation:
  - a. Each business day;
  - b. Based on the records of the firm as at the close of business on the previous business day.
4. When performing an internal client money reconciliation, a firm must either:
  - a. Follow one of the standard methods of internal client money reconciliation set out in the CASS rules; or
  - b. Follow a non-standard method of internal client money reconciliation in accordance with the requirements of the CASS rules.
5. A firm which has adopted the normal approach to segregating client money is required to use the internal client money reconciliation to check whether its client money resource, as at close of business on the previous business day, was equal to its client money requirement at the close of business on that previous day.
6. A firm that adopts the alternative approach to segregating client money is required to use the client money reconciliation to ensure that its client money resource at the close of

business on any day it carries out an internal client money reconciliation is equal to its client money requirement at the close of business on the previous day.

7. Before using a non-standard method of internal client money reconciliation, a firm must send a written report to the FCA prepared by an independent auditor of the firm in line with a reasonable assurance engagement stating whether in the auditor's opinion:
  - a. the method of internal client money reconciliation which the firm will use is suitably designed to enable it to (as applicable):
    - i. (for the normal approach to segregating client money) check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis; or
    - ii. (for the alternative approach to segregating client money) calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis; and
  - b. the firm's systems and controls are suitably designed to enable it to carry out the method of internal client money reconciliation the firm will use.
8. The FCA in PS14/9 state:

"The report will be prepared on the basis of a reasonable assurance engagement. We understand this is achievable under the FRC's definition of a reasonable assurance engagement. Nothing in these rules stipulates what steps an auditor must take to be able to provide firms with the report on the basis of a reasonable assurance engagement. We understand it is likely that many firms will need to have designed their processes and to have built test systems before an auditor feels able to provide the report. However, the specific steps an auditor may need to follow, and the matters which a firm may need to address before the auditor issues a reasonable assurance report, are matters for the auditor's professional judgment as governed by the requirements and standards imposed on the auditor by its regulator."

9. An illustrative example of such a report is set out below.

### **REASONABLE ASSURANCE REPORT TO XYZ PLC ON ITS PROPOSED USE OF THE NON-STANDARD METHOD OF INTERNAL CLIENT MONEY RECONCILIATION**

You have informed us that you intend to adopt the non-standard method of internal client money reconciliation and send to the Financial Conduct Authority (FCA) a report by an independent auditor in accordance with CASS 7.15.18R. At your request, we have performed a reasonable assurance engagement on the suitability of the design of those systems and controls that relate to the adoption of the non-standard method.

## Respective responsibilities of firm and auditor

The firm is responsible for designing systems and controls that enable it to comply with the relevant requirements of the CASS rules of the FCA which are applicable to the non-standard method of internal client money reconciliation. Our responsibility is to perform a reasonable assurance engagement and express an opinion on the suitability of the design of such systems and controls that management proposes to establish that will enable the firm to comply with the relevant CASS rules. Our engagement will be carried out in accordance with the requirements of the Client Asset Assurance Standard issued by the Financial Reporting Council.

### [Inherent limitation in our engagement

As the firm has not yet implemented the systems and controls whose design we have evaluated we are not able to, and do not, provide any assurance as to whether:

- a. the systems and controls will be put in place as designed; or
- b. the systems and controls will operate effectively.]

### Opinion

In our opinion:

- a. the method of internal client money reconciliation which the firm will use is suitably designed to enable it to *[as applicable]*:
  - i. *[for the normal approach to segregating client money]* check whether the amount of client money recorded in the firm's records as being segregated in client bank accounts meets the firm's obligation to its clients under the client money rules on a daily basis; or
  - ii. *[for the alternative approach to segregating client money]* calculate the amount of client money to be segregated in client bank accounts which meets the firm's obligations to its clients under the client money rules on a daily basis; and
- b. the firm's systems and controls are suitably designed to enable it to carry out the method of internal client money reconciliation the firm will use.

*[Signature]*

*John Smith for and on behalf of [Name of audit firm]*

*Address*

*Date*

## ILLUSTRATIVE EXAMPLE OF A CONFIRMATION LETTER FROM THE AUDITOR TO THE FIRM REGARDING A NON-STATUTORY CLIENT MONEY TRUST

[Name of Firm]

[address]

Dear Sirs:

### ***[Firm name] Systems and controls relating to non-statutory client money trusts***

In accordance with the requirements of CASS 5.4.4 R(2) you have engaged us to confirm that you have in place systems and controls which are adequate to meet the requirements of CASS 5.4.4 R(1).

In providing the confirmation set out at the conclusion of this letter, and as previously agreed with you, we have followed the relevant requirements of the Client Asset Assurance Standard issued by the Financial Reporting Council.

### **Confirmation**

We confirm that [insert name of firm] has in place systems and controls which are adequate to meet the requirements of CASS 5.4.4R(1). Specifically we confirm that [insert name of firm] has and maintains systems and controls which are adequate to ensure that [insert name of firm] is able to monitor and manage its client money transactions and any credit risk arising from the operation of the trust arrangement [and such systems and controls extend to both the [insert name of firm] statutory trusts (under CASS 5.3) and non-statutory client money trusts (under CASS 5.4)].<sup>16</sup>

Yours faithfully

[Name of audit firm]

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<sup>16</sup> The wording in square brackets need only be included where, in accordance with CASS 5.4.2R a firm complies with both the rules in CASS 5.3 and 5.4 as such systems and controls are required to extend to both arrangements.



## THE CASS AUDITOR'S DUTY TO REPORT TO THE FCA

1. Under the Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001 (the 2001 Regulations)<sup>17</sup>, CASS auditors have duties in certain circumstances to make reports to the FCA. Information and opinions to be communicated are those meeting the criteria set out below which relate to matters of which the CASS auditor<sup>18</sup> of the firm has become aware:
  - (i) in their capacity as CASS auditor of the firm, and
  - (ii) if they are also the auditor of a person who has close links with the firm, in their capacity as auditor of that person.
  
2. The criteria for determining the matters to be reported are as follows:
  - (i) the CASS auditor reasonably believes that there is, or has been, or may be, or may have been a contravention of any 'relevant requirement' that applies to the firm concerned and that contravention may be of material significance to the FCA in determining whether to exercise, in relation to that firm, any of its functions under FSMA 2000, or
  - (ii) the CASS auditor reasonably believes that the information on, or its opinion on, those matters may be of material significance to the FCA in determining whether the firm concerned satisfies and will continue to satisfy the 'threshold conditions'.
  
3. In relation to 2 (i) above, 'Relevant requirement' is a requirement by or under FSMA 2000 which relates to authorisation under FSMA 2000 or to the carrying on of any regulated activity. This includes not only relevant statutory instruments but also the FCA's rules (other than the Listing Rules) including the Principles for Businesses. The duty to report also covers any requirement imposed by or under any other Act<sup>19</sup> the contravention of which constitutes an offence which the FCA has the power to prosecute under FSMA 2000.
  
4. In relation to 2 (ii) above the duty to report relates to either information or opinions held by the CASS auditor which may be of significance to the FCA in determining whether the firm satisfies and will continue to satisfy the 'Threshold Conditions'. The duty to report opinions, as well as information, allows for circumstances where adequate information on a matter may not readily be forthcoming from the firm, and where judgments need to be made.

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<sup>17</sup> Statutory Instrument 2001 No. 2587.

<sup>18</sup> An 'auditor' is defined for this purpose in the Regulations as a person who is, or has been, an auditor of an authorised person appointed under, or as a result of, a statutory provision including Section 340 of FSMA 2000.

<sup>19</sup> Examples include Part 5 of the Criminal Justice Act 1993 and prescribed regulations relating to money laundering.

## Material significance

5. Determining whether a contravention of a relevant requirement or a Threshold Condition is reportable under the 2001 Regulations involves consideration both of whether the CASS auditor 'reasonably believes' and that the matter in question 'is, or is likely to be, of material significance' to the regulator.
6. In circumstances where a CASS auditor identifies that a reportable matter may exist, it carries out such additional procedures, as it considers necessary, to determine whether the facts and circumstances cause it 'reasonably to believe' that the matter does in fact exist. It should be noted that the CASS auditor's work does not need to prove that the reportable matter exists.
7. Where an apparent breach of statutory or regulatory requirements comes to the CASS auditors' attention, it should obtain such evidence as is available to assess its implications for the CASS auditor's reporting responsibilities and determine whether, in its opinion, there is reasonable cause to believe that the breach has occurred and that it relates to a matter that is of material significance to the FCA.
8. 'Material significance' is defined as follows:

*"A matter or group of matters is normally of material significance to a regulator's function when, due either to its nature or its potential financial impact, it is likely of itself to require investigation by the regulator."*
9. The determination of whether a matter is, or is likely to be, of material significance to the FCA inevitably requires the CASS auditor to exercise judgment. In forming such judgments, the auditor needs to consider not simply the facts of the matter but also their implications. In addition, it is possible that a matter, which is not materially significant in isolation, may become so when other possible breaches are considered.
10. The CASS auditor of a firm bases its judgment of 'material significance' to the FCA solely on their understanding of the facts of which they are aware without making any assumptions about the information available to the FCA in connection with any particular firm.
11. Minor breaches of the FCA's rules that, for example, are unlikely to: jeopardise the safeguarding of client's assets; or amount to misconduct; or mismanagement would not normally be of 'material significance'. In circumstances where a CASS auditor is uncertain whether it may be required to make a report or not, it may wish to consider taking legal advice.
12. On completion of its investigations, the CASS auditor ensures that the facts and circumstances, and the basis for its conclusion as to whether these are, or are likely to be of 'material significance' to the FCA, are adequately documented such that the reasoning for its decision to report or not, as the case may be, may be clearly demonstrated.

13. Whilst confidentiality is an implied term of CASS auditors' contracts with a firm, section 342 of FSMA 2000 states that an auditor does not contravene that duty if he reports to the FCA information or his opinion, if the auditor is acting in good faith and reasonably believes that the information or opinion is relevant to any function of the FCA. The protection afforded is given in respect of information obtained in his capacity as [CASS] auditor.

# CONTEXTUAL MATERIAL TO THE CLIENT ASSET ASSURANCE STANDARD

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## Background

1. The UK has a large number of financial services firms that may hold client money and custody assets (referred to collectively as “**client assets**”) belonging to their clients. The Financial Conduct Authority’s (FCA’s) 10<sup>th</sup> Principle for Businesses is that “A firm must arrange adequate protection for clients’ assets when it is responsible for them”.
2. Rules in respect of the 10<sup>th</sup> principle are set out in the FCA’s Client Assets Sourcebook (CASS rules) which require firms to hold client money and custody assets separately from their own in order to minimise the risk of loss to clients in the event of the firm’s insolvency. Such losses may arise, for example, from the claims of its general creditors and from right of set-off by institutions which hold the custody assets or client money. Other FCA rules may also be applicable to CASS auditors. An example of such other FCA rules are the FCA’s Supervisory (SUP) rules.
3. The Financial Services and Markets Act 2000 (FSMA 2000) together with other legislation such as the Companies Act 2006 provide the statutory framework for the obligations of firms and CASS auditors. FSMA 2000 permits the FCA to have rules requiring a firm to appoint an auditor and to impose “other duties” on the auditor of the firm. The duty of an auditor to prepare and submit a Client Assets Report to the FCA is such an “other duty”. However, a firm need not appoint its statutory auditor to be its CASS auditor.

### Requirement to protect clients’ safe custody assets and client money

4. The fundamental requirement to protect client assets is set out in CASS 6.2.1R with respect to safe custody assets and in CASS 7.12.1R with respect to client money. These CASS rules are as follows<sup>20</sup>:

**CASS 6.2.1R** A firm must, when holding safe custody assets belonging to clients, make adequate arrangements so as to safeguard clients’ ownership rights, especially in the event of the firm’s insolvency, and to prevent the use of safe custody assets belonging to a client on the firm’s own account except with the client’s express consent.

**CASS 7.12.1R** A firm must, when holding client money, make adequate arrangements to safeguard the client’s rights and prevent the use of client money for its own account.

### Requirement to have adequate organisational arrangements

5. The provisions of the Market in Financial Instruments Directive (MiFID) and the FCA’s rules in the CASS Sourcebook might be taken to imply that client assets and money held

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<sup>20</sup> These Explanatory Notes quote certain of the CASS rules in order to illustrate the discussion of the fundamental principles underlying the CASS rules. It is important that a CASS auditor has an understanding of all CASS rules relevant to the engagement it is undertaking and should not rely on reading these notes as a substitute for such knowledge.

by a firm are generally protected, including on the insolvency of the firm. However, this may not always be the case because the interaction between the CASS rules and English law leaves such assets susceptible to various operational risks, such as those arising from inaccurate record-keeping on the part of the firm. There is a consequent risk for clients of the firm who have entrusted their assets or monies to the firm to share resulting losses with other clients of the firm with whom they are not connected.

6. The requirements to protect clients' assets and the operational risks described above give rise to requirements for CASS firms to have adequate organisational arrangements. These fundamental Rules are as follows:

**CASS 6.2.2R** A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of clients' safe custody assets, or the rights in connection with those safe custody assets, as a result of the misuse of the safe custody assets, fraud, poor administration, inadequate record-keeping or negligence.

**CASS 7.12.2R** A firm must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client money, or of rights in connection with client money, as a result of misuse of client money, fraud, poor administration, inadequate record-keeping or negligence.

7. In essence the CASS auditor reports on whether the rules surrounding these requirements have been complied with by the firm during the period and whether the firm was in compliance with those rules at the end of the period.

#### **Four fundamental principles**

8. There are perhaps four fundamental principles that underlie the CASS requirements:

**Identification:** Has the firm identified where client assets may arise in its business? This can be a far from straightforward matter and requires those responsible for the identification of client assets to have a thorough knowledge of the firm's business model and of its cash inflows and outflows.

**Segregation/Safeguarding** Does the firm segregate client monies and safeguard custody assets in a manner that is likely to be legally effective such that in the event of the insolvency of the firm client assets will be returned on a timely basis to their beneficial owners.

**Reconciliation** The firm should perform internal and external reconciliations at the frequency required by the rules. An internal client money reconciliation is between a firm's internal records and accounts of the amount of client money held for each client with its

internal records and accounts of the aggregate amount of client money that the firm should be holding in client bank accounts or have placed in client transaction accounts. An external reconciliation is between the firm's internal records and the records of the financial institution with which the monies have been deposited.

**Trust/Legal title** The firm should establish and obtain acknowledgement of the trust status over client money and legal title to custody assets.

## Other CASS Rules

9. There are aspects of the Client Asset rules other than the distinction between custody assets (CASS 6) and client money (CASS 7). There are also rules relating to:

**Collateral (CASS 3)** which provide protection for those assets subject to a "right to use arrangement" under which a client gives a firm certain rights to use an asset and the firm treats the asset as if legal title and associated rights to that asset had been transferred to the firm subject only to an obligation to return equivalent assets to the client upon satisfaction of the client's obligation to the firm.

**Insurance Intermediaries (CASS 5)** which establish specific requirements for firms (such as insurance brokers) that undertake insurance mediation activity and hold client money. The requirements of CASS 5 are broadly similar to the client money rules in CASS 7 but there are some significant differences.

**Mandates (CASS 8)** – these rules apply to a firm in respect of any authority from a client under which the firm may control a client's assets or liabilities in the course of, or in connection with, the firm's:

- a. Investment business; and/or
- b. Insurance mediation activity.

**Debt Management Firms that receive or hold client money (CASS 11)** – a debt management firm is a firm which:

- a. Carries on the activities of debt counselling or debt adjusting, alone or together, with a view to an individual entering into a particular debt solution; or
- b. Carries on the activity of debt counselling where an associate carries on debt adjusting with the aim in (a) in view; or
- c. Carries on debt adjusting where an associate carries on debt counselling with the aim of (a) in view; or
- d. Is a not-for-profit debt advice body

**Claims Management Companies that receive or hold client money (CASS 13)** – a claims management company is a firm which carried on a regulated claims management activity.

## **Key Principles underlying the CASS rules**

10. The following table sets out the key principles that the CASS auditor considers with respect to the various CASS rules. It is not exhaustive, and auditors should consider all of the relevant CASS rules and use professional judgment to determine what risks are important to the circumstances of each client.



	PRINCIPLE	CASS 3 Collateral	CASS 5 Insurance Intermediaries	CASS 6 Custody Assets	CASS 7 Client Money	CASS 8 Mandates	CASS 11 Debt management firms	CASS 13 Claims management companies
1.	<b>Identification:</b> The firm should identify all sources of client assets and mandates in its business	✓	✓	✓	✓	✓	✓	✓
2.	<b>Protecting client assets:</b> The firm should make adequate arrangements to safeguard client ownership rights on the insolvency of the firm	✓	✓	✓	✓		✓	✓
3.	<b>Organisational arrangements:</b> The firm's organisational arrangements should be adequate such that they comply with the CASS Rules	✓	✓	✓	✓	✓	✓	✓
	Arrangements in respect of registration and recording of legal titles			✓				
	Segregation of client money		✓		✓		✓	✓
	Safe custody assets used only as permitted by the CASS Rules	✓		✓				
4.	<b>Accurate records and accounts:</b> The firm should have records and accounts that are maintained with sufficient accuracy (and on a timely basis) to enable the firm to comply with the CASS Rules	✓	✓	✓	✓	✓	✓	✓

	PRINCIPLE	CASS 3 Collateral	CASS 5 Insurance Intermediaries	CASS 6 Custody Assets	CASS 7 Client Money	CASS 8 Mandates	CASS 11 Debt management firms	CASS 13 Claims management companies
5.	<b>Reconciliations:</b> The firm should perform internal and external reconciliations in accordance with the CASS Rules at the requisite frequency in order to rectify discrepancies.		✓	✓	✓		✓	✓
6	<b>Rectify discrepancies in reconciliations:</b> The firm should ensure that discrepancies arising from reconciliations are rectified appropriately.		✓	✓	✓		✓	✓
7	<b>Trust:</b> The firm should notify and obtain acknowledgement of trust status over client money.		✓		✓		✓	✓
8	<b>Non-statutory trust:</b> The firm should ensure that the conditions for establishing a non-statutory trust are met		✓					
9	<b>Custody agreements:</b> The firm should have appropriate custody arrangements setting out the status of client custody accounts and prohibiting inappropriate liens			✓				
10	<b>Client money distributions:</b> The firm should ensure that client money distributions are carried out in accordance with the CASS Rules		✓		✓		✓	✓

## **Reasonable Assurance Client Assets Reports**

11. Where the firm holds custody assets and/or client money, the SUP rules require the CASS auditor to provide a Reasonable Assurance Client Assets Report to the FCA . This is a direct reporting assurance engagement whereby the CASS auditor’s opinion (subject matter information) is expressed in terms of the “underlying subject matter” and the “applicable criteria” rather than as an opinion on an assertion made by management.
12. The objective of the CASS auditor is to carry out procedures which will provide a high but not absolute level of assurance that reduces “assurance engagement risk” to an acceptably low level as a basis for a positive form of expression of the CASS auditor’s opinion.

## **Underlying Subject Matter**

13. The “underlying subject matter” of a reasonable assurance engagement is:
  - a. The adequacy of the systems maintained by the firm to enable it to comply with the relevant CASS rules throughout the period since the last date at which a report was made;
  - b. The firm’s compliance with the relevant CASS rules at the period end date; and
  - c. The Breaches Schedule appended to the CASS auditor’s report.

## **Reasonable Assurance Process**

14. An overview of the process to form the opinion as to whether the firm was in compliance with the relevant CASS rules throughout and at the end of the period and the relevant considerations relating to various stages in the process is depicted in Appendix 1 of the Client Asset Assurance Standard.
15. Procedures required to form the opinion on the adequacy of systems involve:
  - a. evaluating the design of the systems and controls;
  - b. evaluating whether those systems and controls had been put into place during the period; and
  - c. testing the effectiveness of the operation of the systems and controls during the period.
16. Procedures required to form the opinion on compliance with the CASS rules at the period end date involve evaluating whether or not the firm was in compliance with all relevant CASS rules at that date.

## **Applicable Criteria**

17. Applicable criteria may comprise a combination of:
  - a. Provisions of the CASS Sourcebook having the suffix “R” (see paragraph 21);

- b. Waivers and Modifications granted by the FCA (see paragraph 26); and
- c. Individual guidance from the FCA to a firm (see paragraph 27).

### **Applicable Criteria – The CASS rules in the CASS Sourcebook**

- 18. The applicable criteria used to evaluate the subject matter are the relevant CASS rules and any other rules of the FCA that are applicable to the firm. For this purpose, a “rule” is a provision of the CASS Sourcebook having the suffix “R” (see paragraph 21).
- 19. The CASS Sourcebook contain different types of provisions whose status is indicated by different suffixes:
  - a. “R” – Rule;
  - b. “E” – Evidential Provision (An evidential provision is a rule that is not binding in its own right. It always relates to another binding rule).
  - c. “G” – Guidance.
- 20. A rule is a binding obligation on firms that the FCA regulates and if contravened a firm commits a “breach” which renders it subject to potential enforcement action and in some circumstances an action for damages.

### **Applicable Criteria – Guidance in the CASS Sourcebook**

- 21. A number of the provisions in the CASS Sourcebook are guidance (rather than rules). CASS guidance can have a number of objectives such as indicating the implications of other provisions, possible means of compliance to linked rules; or recommending a particular course of action or arrangement. Guidance is generally designed to throw light on a particular aspect of regulatory requirements, not to be an exhaustive description of firm’s obligations.
- 22. Guidance in the CASS rules are not applicable criteria per se. However, where a firm has not followed the guidance, the CASS auditor carefully considers whether the firm has, nevertheless, remained in compliance with the linked rule. In some circumstances, if the firm chooses not to apply the guidance it may need to undertake actions specified in a rule in order to comply with that rule.

### **References to CASS rules and guidance in the Standard**

- 23. Members of a CASS engagement team need to have an appropriate knowledge of the CASS Sourcebook. Although references to certain CASS rules and guidance are made in the Standard and accompanying implementation guidance, such references are not a substitute for an understanding of the CASS Sourcebook as a whole. Any references to specific CASS rules and guidance in the Standard and accompanying implementation guidance are not, and should not be construed as being, interpretations of such rules or guidance.

## **Applicable Criteria – Waivers and Modifications**

24. A firm can apply to the FCA for a waiver or a modification of provisions in CASS. If a waiver or modification is granted by the FCA, the firm must comply with the waiver or modification in accordance with the formal written direction provided to that firm by the FCA. If the CASS auditor determines a firm has received any CASS-related waiver or modification notices it must use the provisions set out in the waiver or modification as criteria. A breach of the waiver or modification provision relating to a CASS rule constitutes a breach that is reportable in the breaches schedule.

## **Applicable Criteria – Individual Guidance**

25. The FCA can also provide individual guidance to a firm about how it should interpret a particular provision in the particular circumstances that apply to the firm. Such individual guidance may be requested by the firm or can be provided to a firm on the FCA's initiative. If the guidance has not been provided in writing, the CASS auditor would normally request written confirmation of the guidance. Such individual guidance constitutes "criteria" for the CASS auditor.

## **Breaches Schedule**

26. The CASS auditor is required to provide the FCA with a schedule (appended to its report) which lists each CASS rule in respect of which a breach has been identified. The breaches schedule is required to include every breach of a rule that is within the scope of the Client Assets Report of which the CASS auditor is aware, whether identified by the CASS auditor or disclosed to the CASS auditor by the firm or by any third party.

## **Limited Assurance Client Assets Reports for investment businesses**

27. The need for a Limited Assurance Client Assets Report for an investment business may arise under two general circumstances:
- a. Firms that have permission to hold either custody assets or client money may claim not to hold them; or
  - b. The scope of the firm's permissions may not include the holding of client money or custody assets.
28. The CASS auditor is required under such circumstances to provide its opinion as to whether "nothing has come to its attention that causes it to believe that the firm held client money or custody assets during the period". In the Standard, requirements in relation to the provision of limited assurance reports are addressed separately from the requirements in relation to the provision of reasonable assurance reports.

## **Need to understand the firm's business model**

29. In order to provide a basis for establishing expectations about the existence or otherwise of client assets, the auditor needs to have a sufficient understanding of the firm's business model to enable it to assess:
- a. In the case of a firm having permission to hold client assets and actually holding such assets, whether the existence of all categories of client assets are being reported to the FCA; and

- b. In the case of a firm claiming not to hold client assets, whether the claim is valid based on the CASS auditor's knowledge of the business model.

## **CASS Operational Oversight**

30. It is critical for the firm to understand the interrelationship of its business model and inflows and outflows of cash and assets with the CASS rules. It is important for the CASS auditor to be knowledgeable of the firm's understanding of the interrelationship. Investment firms (but not insurance intermediaries) are required to appoint an individual to be responsible for oversight of the firm's operational compliance with CASS. Dependent on the quantum of client money or assets held, this individual is either appointed to fulfil a controlled function or is a director or senior manager approved for another significant influence function.
31. The Client Money and Asset Return (CMAR), which a firm is required to submit to the FCA periodically, is intended to give the FCA an overview of firm-specific CASS positions and an overview of CASS holdings.
32. The CASS auditor is not required to report on the firm's compliance with the CMAR requirements. However, reading the CMAR is likely to assist the CASS auditor in understanding the firm's business. The CASS auditor, therefore, should review the firm's CMAR submissions and assess their consistency with its knowledge of the firm's business. If such reviews reveal inconsistencies between the CMARs and the CASS auditor's understanding, it seeks to understand the reasons for the inconsistencies.

## **Planning and performing the CASS audit**

33. The extent and nature of a CASS auditor's risk assessment procedures is driven by the CASS auditor's evaluation of the "significance" to its opinion of a firm's failure to comply with a CASS rule. Evaluating "significance" involves a combined assessment of the likelihood of a firm failing to adequately manage or mitigate a risk and an assessment of whether client assets have been dealt with in accordance with the CASS rules.
34. The CASS auditor's work should be designed to provide either reasonable or limited assurance. The CASS auditor is not required to provide absolute assurance and, therefore, the concepts of "significance" and sampling may be applied by the CASS auditor both in developing its CASS methodology and when planning and performing individual CASS audits.
35. Significance and sampling are applied as the basis for the CASS auditor's judgments for:
  - a. Determining the nature, timing and extent of risk assessment procedures;
  - b. Identifying and assessing the risk of non-compliance with individual CASS rules; and
  - c. Determining the nature, timing and extent of further CASS audit procedures to test the firm's compliance with the CASS rules, in particular the determination of sample sizes when testing internal controls.

## **Reporting Breaches to the FCA**

36. The FCA requires all breaches identified by the CASS auditor to be reported to it whether identified by the auditor or disclosed to the auditor by the firm, or by any third party. The materiality or significance of a breach of the CASS rules, therefore, are not relevant considerations in determining whether the breach of a CASS rule needs to be reported to the FCA by the CASS auditor. For example, a failure to place client money promptly into a segregated client bank account is a reportable breach of the CASS rules regardless of whether the amount concerned is £5 or £5 million.

## **Awareness of insolvency and trust law**

37. As discussed above, when providing assurance on client assets the CASS auditor is expected to have an understanding of how the CASS rules seek to effectively segregate client assets within the context of applicable trust and insolvency law. The extent of the understanding that the CASS auditor should have is that which enables it to appreciate the likely effectiveness of the firm's procedures in protecting client assets were it to become insolvent.
38. In this regard it is important that CASS auditors appreciate that insolvency law has application to legal entities rather than to businesses within consolidated groups that may encompass a number of legal entities or form only part of a legal entity. As insolvency law may not permit the Courts to see through the "corporate veil" of the limited liability of individual legal entities, client asset protection usually needs to be structured in the context of the legal entity that holds those client assets rather than in the context of the business within which that legal entity operates. If a CASS auditor becomes aware that client assets are being transferred to affiliates such that they may no longer enjoy the same legal protection as if they had not been transferred, the CASS auditor considers taking advice on the implications for either its Client Assets Report or its other responsibilities.

## **Internal control**

39. A firm's systems and controls over client assets may be quite distinct from the systems and controls that it has over its own assets. Consequently, it would be wholly inappropriate for the CASS auditor to draw conclusions about the design and operating effectiveness of the systems and controls over client assets based on evaluations of the firm's systems and controls over its own assets, except for where the controls, governance and oversight processes are common.
40. For these reasons the work required to express an opinion on the adequacy of the systems as required by the CASS rules may require a much more detailed evaluation of design and operating effectiveness of internal controls over client assets than that obtained by an auditor in order to express an opinion on the financial statements.

## **Third party administration of client assets**

41. Firms may enter into arrangements with a "Third Party Administrator" (TPA) to outsource the operation of certain functions that are relevant to the firm's compliance with CASS

rules. Such arrangements may be structured such that the firm retains full regulatory responsibility for compliance with CASS rules in respect of the outsourced functions. In simple terms, the firm retains regulatory responsibility where the TPA does not have a contractual relationship with the firm's client and simply has a contractual obligation to the firm to perform certain services on its behalf.

42. Alternatively, the firm and its TPA may agree to an arrangement in which the TPA takes direct responsibility for compliance with some or all of the provisions in CASS rules. In the stockbroking industry this may arise where a second firm takes responsibility for the stockbrokers' clearing and settlement activities (give up broking). In such a scenario, the second firm is responsible for compliance with the FCA's rules (including the CASS rules) insofar as they apply to clearing and settlement processes that are the subject of the arrangement.
43. A TPA can only assume such responsibility if it is authorised by the FCA to conduct investment business and has the requisite permission from the FCA to hold or control the client money and/or custody assets in question. Such a transfer of responsibility only occurs if the firm's clients enter into terms of business with the TPA to establish that the TPA will be directly responsible to the client under CASS rules for protecting the clients' money or assets. In order to do so, the firm, the TPA and the client may enter into a tripartite agreement that reflects the terms of business between both firms and the client. Alternatively, the firm and the TPA may each enter into separate agreements with the client to achieve this.
44. The actual arrangements entered into by firms can be extremely complex and members of a CASS audit engagement team need to have a thorough understanding both of the arrangements with the TPA and the firm's clients and of the firm's business model, particularly of the cash and other asset inflows and outflows as they apply both to the firm and to the TPA. This understanding provides a basis for establishing the respective regulatory responsibilities of the firm and (if any) the TPA for client assets and, therefore, expectations about the existence or otherwise of client assets.

## **Forming and managing the Client Asset Engagement Team**

45. It is important that careful consideration is given both to the composition of the Client Asset Engagement Team and the manner in which it is managed and organised. As members of the CASS engagement team need to have knowledge and understanding of the CASS and other relevant FCA Rules sufficient to perform the engagement, the CASS engagement should not be considered to be a part of the statutory audit of the financial statements. Reporting on client assets is a distinct specialism requiring, in respect of more complex firms, that the members of the engagement team should include client asset specialists.
46. The nature of many firms' businesses requires them to respond to rapidly changing and evolving markets. New and more sophisticated products and practices may require specialist assurance responses from the CASS engagement team. It is important, therefore, that the CASS engagement team is familiar with current practice.



47. In determining whether the proposed assurance engagement team collectively possess the requisite professional competency, the CASS engagement leader assesses whether they have sufficient knowledge of the specific aspects of the industry within which the firm operates and its corresponding products. The CASS engagement leader also assesses whether the client asset engagement team has sufficient knowledge of the regulatory framework within which the firm operates commensurate with their roles in the engagement.
48. In larger and more complex regulated firms handling client assets, the firm will rely on IT systems, for instance to synchronise and reconcile custody assets and client money, and exchange data with custodians. The use of IT specialists, appropriately trained in the implications of their work for the work of the CASS auditor, should be considered by the CASS engagement leader.

## **Training**

49. The different mind-set required to complete CASS assurance engagement coupled with the FCA's information needs from the CASS auditor have implications for the training of CASS auditors. The CASS engagement team is likely to need training relevant to the circumstances of the engagement, for instance in the following:
  - a. The FCA's CASS rules and in particular what constitutes a breach of those Rules;
  - b. The firm's business model such that reasonable expectations can be developed by the CASS auditor as to whether a firm is likely to have client assets;
  - c. Practical problems associated with the performance and review of internal and external client asset reconciliations;
  - d. Assessing the design effectiveness of the systems of internal control over client assets, evaluating whether the systems of internal control were in effect throughout the period and operating effectively; and
  - e. Insolvency and trust law in so far as to create an awareness of how the principles of segregation and tracing protect the rights of beneficial owners of client assets in the event of the insolvency of a firm.
50. The CASS auditor is engaged to report on compliance with the CASS Rules. The question of whether or not client assets are effectively ring-fenced is a legal determination and CASS auditors, when reporting on compliance with CASS, are not expected to interpret the general law or predict whether the Courts would determine that assets have been effectively ring-fenced.
51. When providing assurance on client assets the CASS auditor is expected to understand what the CASS Rules are seeking to achieve within the context of trust and insolvency law. The extent of the understanding that the CASS auditor should have is that which enables it to be sceptical about the likely effectiveness of the firm's procedures in protecting client assets were it to become insolvent.

## Special Reports

The CASS rules permit, in certain circumstances, firms to operate:

- a. An “alternative approach” to client money segregation; and
  - b. A “non-standard method” of internal client money reconciliation.
52. In both cases the FCA expect the firm to obtain, before carrying out the proposed approach/method, an auditor’s report prepared on the basis of a reasonable assurance engagement to the effect that the proposed approach/method will achieve the desired regulatory outcome. The Client Asset Assurance Standard has a separate section of requirements relating to the provision of reasonable assurance with respect to such Special Reports.





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