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CASS – What you need to know

6 February 2019

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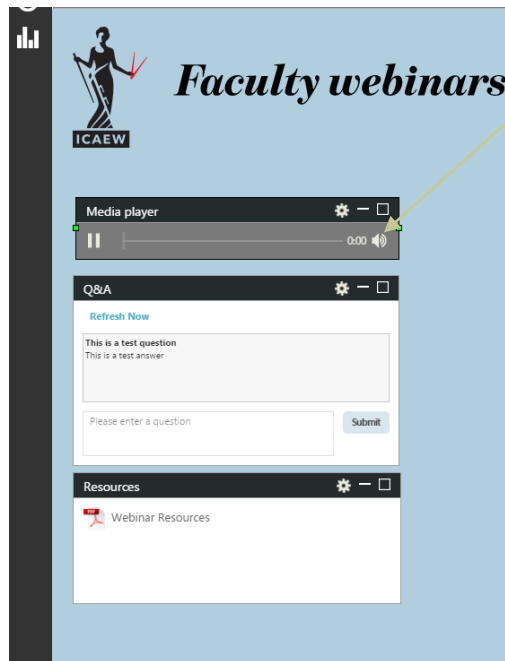


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Introduction



Audio problems?

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Client Assets and CASS Audits

ICAEW Webinar

6 February 2019

Emad Aladhal, Head of Department
FCA Client Assets and Resolution Department

Continued focus on Client Assets compliance

- Focused on reducing or preventing harm
- Specialist supervisory programme
- Proactive engagement
- Tailored approach

3,200
Firms with
permissions

£140bn
of Client
Money

£14tr
of Custody
Assets

What the FCA is seeing

- Improvements in firms' compliance with CASS
- Further improvements needed
- FRC standard driving more detailed auditor reporting

CASS audit reporting

The FCA relies on CASS audit reports

The quality of audit reporting has generally improved

We continue to review audit reports and take appropriate follow-up action

Some reminders for auditors and regulated firms

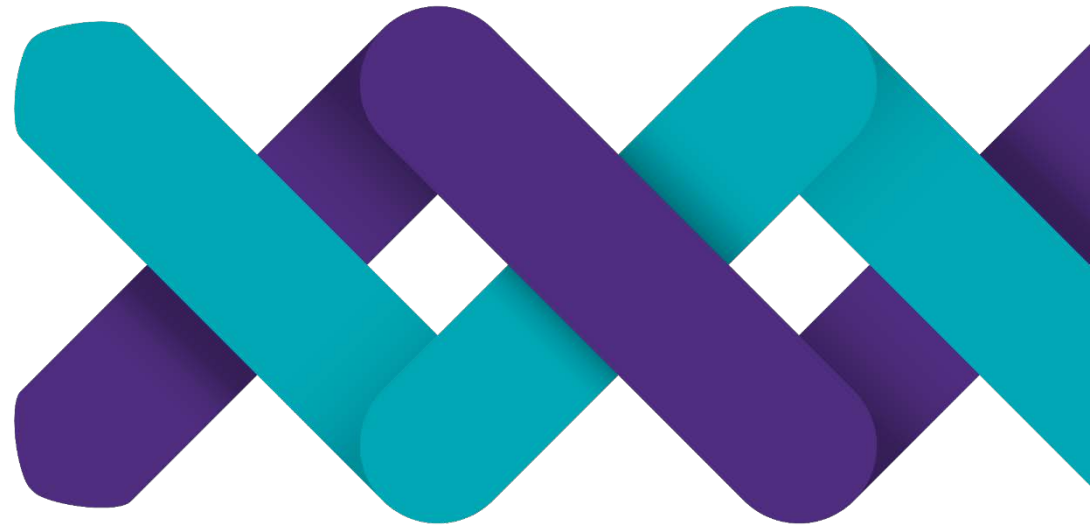
Client Assets and CASS Audits

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FCA Client Assets and Resolution Department

Overview of CASS



Principles underlying CASS

Four fundamental principles underlying CASS:



Identification

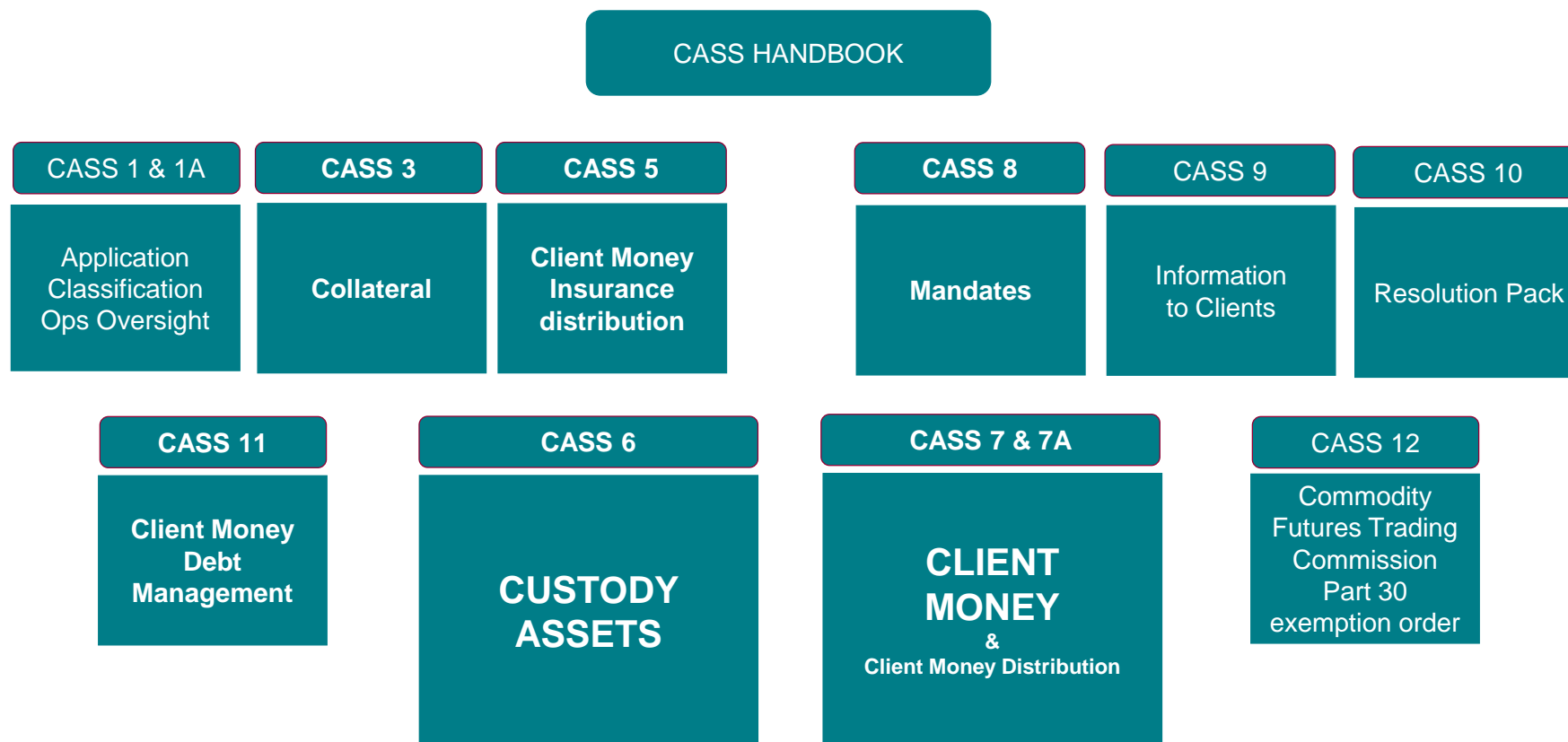
Segregation/Safeguarding

Reconciliation

Trust/legal title

CASS (within Business Standards)

The FCA handbook is divided into individual sourcebooks – the key CASS ones are:



The client money rules

CASS 5 – Insurance distribution activity:

- any premium, claim or return premium received or handled by an insurance intermediary

CASS 7 – Investment business activity:

- money held in relation to MiFID business, designated investment business, stocks and shares, ISA business

CASS 11 – Debt management activity:

- money held by a CASS debt management firm in relation to debt management activity

What is custody?

Includes:

- **MiFID business**
holding financial instruments belonging to a client in the course of MiFID business
- **non-MiFID business**
safeguarding and administering safe custody investments or custody assets (article 40 of the Regulated Activities Order).
- **Acting as trustee or depository of AIF or UCITS.**

On which entities do we report?

FCA-regulated firm (eg not appointed representatives)

not those **scoped-out** of SUP 3 (see SUP 3.1.1A)

- ie not holding client assets and do not appoint an auditor under or as a result of a statutory provision

only those within the **scope of SUP 3.10** (see SUP 3.1.2)

- **in**, for example, insurance intermediary, UK MiFID firm, investment management firm (conditions)
- **not in**, for example, exempt insurance intermediary, some exempt CAD firms

Permissions

- FCA Register
 - *Authorised vs Registered*
- Firm categorisation
 - *MiFID, MiFID exempt, Exempt CAD, Insurance intermediary*
- Understand the client money holding requirement
- Understand the permissions
- Understand the custody asset permissions
 - *Arranging only*
 - *Safeguarding and administration of assets (without arranging)*

Key considerations

Whose
responsibility
is it?

- FCA authorisation status
- What are the permissions?
- Holding of client money and/or custody assets
- Within scope of SUP 3?
- Audit exemption and CASS reporting
- Look out for:
 - small AIFMs and applicability of CASS 6
 - Exempt CAD firms and audit exemption

What do we report?

- an **assurance (audit) opinion**
- form of opinion:
 - **limited** assurance, or
 - **reasonable** assurance
- can '**mix and match**' the two, eg reasonable for client money, but limited for custody assets
- report by the partner/director with primary responsibility for the work, in his/her own name, for and on behalf of the audit firm

Scope of CASS Assurance engagements

Limited assurance report

- firm has relevant permissions but claims it does not hold client money or custody assets
- firm does not have the relevant permissions

Reasonable assurance report

- firm has relevant permissions and claims it does hold or control client money and/or custody assets

- be aware of deadlines and delivery rules
 - **four** months
 - missing the deadline – avoid – see **SUP 3.10.8**

Reasonable assurance engagements

Two key opinions

Where firm has permission to hold, and does hold, client money and/or custody assets:

systems adequate to enable it to comply with the custody rules, collateral rules, mandate rules and client money rules **throughout the period**

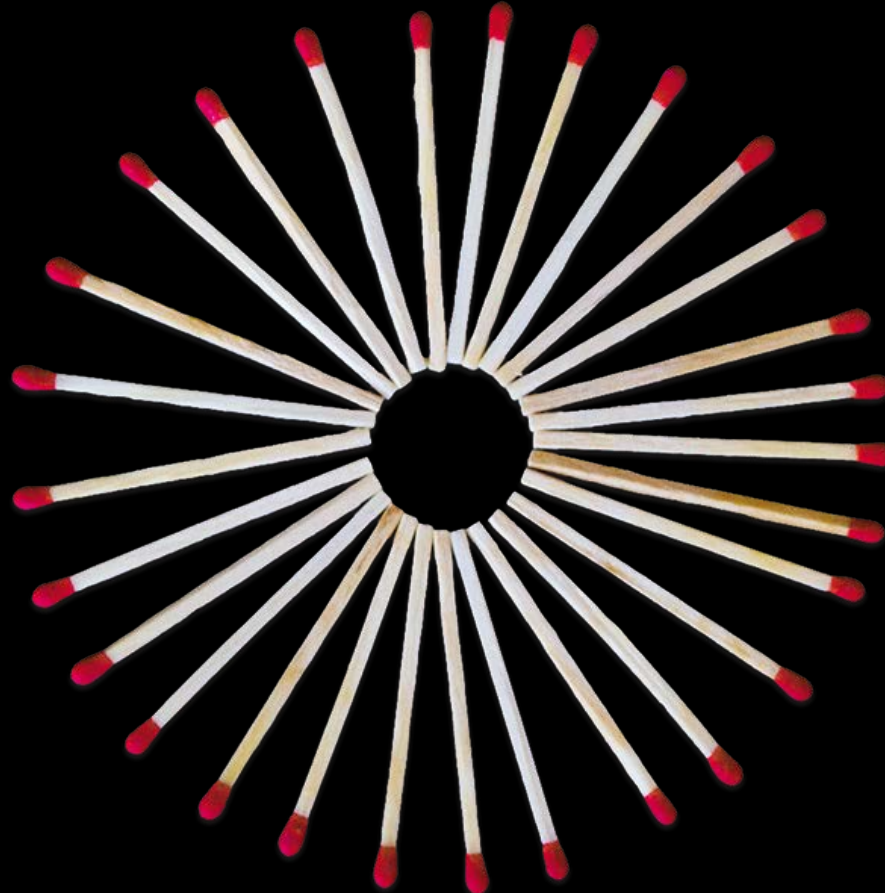
compliance with the custody rules, collateral rules, mandate rules and client money rules **as at the period end date**



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CASS Audits – what you need to know

The FRC Standard

Client Asset Assurance Standard

Introduction

CASS assurance engagements need to be carried out in accordance with the Assurance Standard issued by the Financial Reporting Council ("FRC") in November 2015: Providing Assurance on Client Assets to the Financial Conduct Authority (The "CASS Assurance Standard" or the "Standard").

The Standard was introduced by the FRC to govern the performance of the CASS assurance engagements, often referred to as CASS audits.

Whilst it is important to realise that these engagements are not "statutory audits" it is also important to understand that a firm is still exposed to considerable regulatory scrutiny when undertaking such work.

The material presented seeks to set out some principles for practitioners to use in performing a CASS audit in accordance with the Standard.

Many aspects of a CASS Audit require judgement and detailed procedures carried out will need tailoring to the specific circumstances of each engagement.

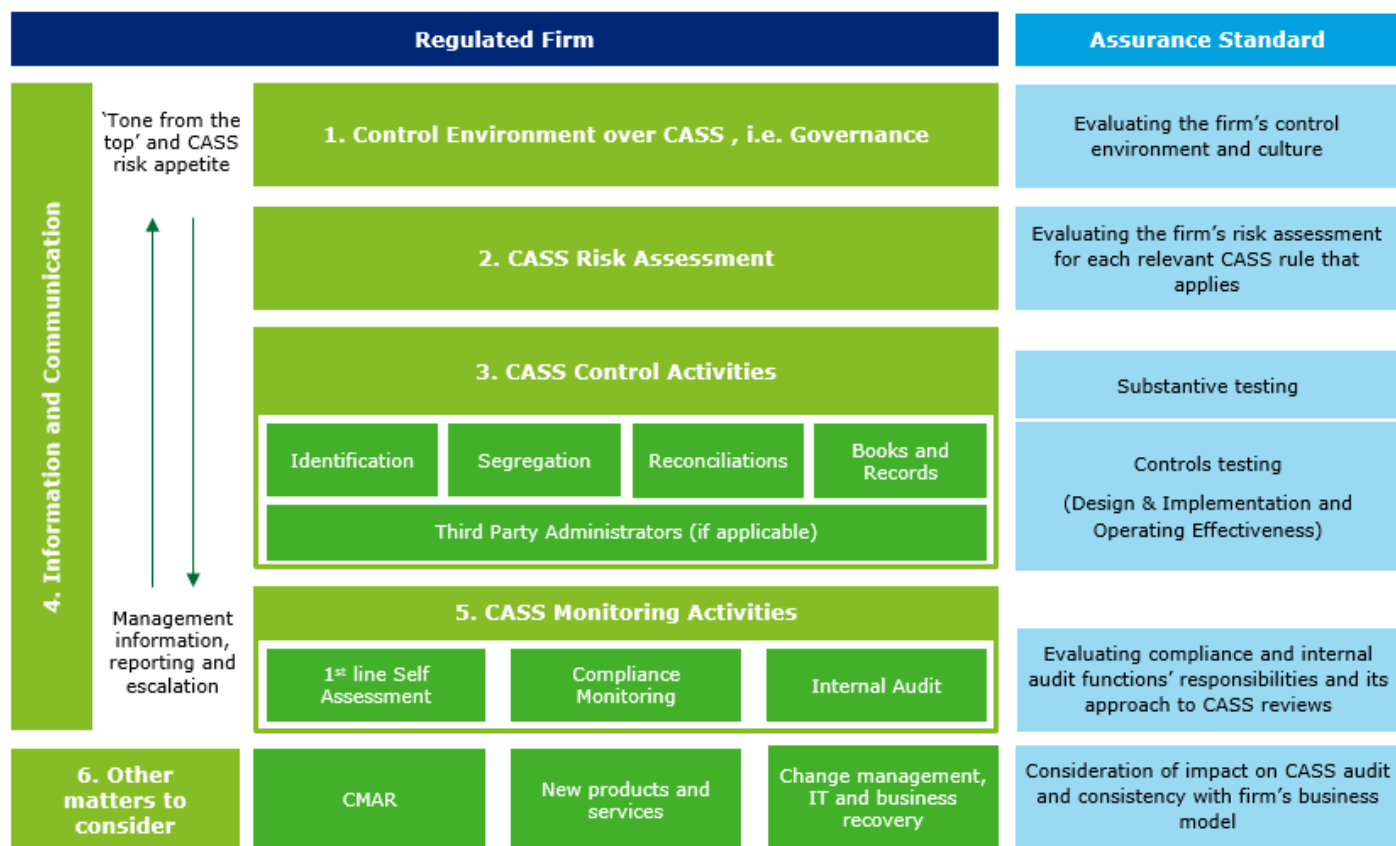
Impact of the FRC Client Asset Assurance Standard on a regulated firm

- To meet the requirements of the Standard a **firm** should have documentation around CASS risks and controls including:
 - A CASS **rule mapping** indicating all CASS rules that are both in and out of scope clearly mapped to each business area subject to CASS.
 - A **risk assessment** identifying all in-scope CASS rules to the risks faced of breaching each CASS rule. For each risk identified, the controls in place to mitigate those risks will then need to be identified and documented.
 - Supporting the controls matrix should be **process maps** for asset and cash-flows that clearly identify where and how client money and assets are held and registered at each stage of the client assets lifecycle.
- From this controls matrix, the auditor should be able to identify which controls sit over which process, and make an assessment of whether the preventative and detective controls are designed in such a way that would ensure on-going compliance with the relevant CASS rule set.
- There will also be a need for details of each group member or third party that performs a CASS function for the firm, the contractual arrangements in place and how the firm exercises oversight of these arrangements.
- If a firm does not have the above or it is not adequate, the auditor must assess the impact on it's approach and opinion.

FRC Client Assets Audit Standard

CASS Control Framework at the firm

The FRC Standard assumes that firms have a CASS Control Framework that the CASS Auditor can assess.



Limited Assurance CASS audit

The FRC standard sets out those matters which should be considered as part of a limited assurance engagement and many of these revolve around the CASS Auditor understanding the business of the firm and why no client money or custody assets are held. Particular care needs to be taken where a firm uses an exemption within the rules, for example, Delivery Versus Payment (DVP), or has permission to hold client money or custody assets but management claim that the firm does not actually hold.

- Understanding the business, i.e. what does the firm do? "No permission" does not equal "no client assets" held.
- Why are there no client money/custody assets? e.g. the firm does not receive client money/custody assets due to the nature of the business.
- Are any exemptions used? If so, how does the firm comply.
- Identify and test controls, e.g. controls to ensure client assets are not held
- Staff training on the awareness of any client assets held during the period
- Consider the results of audit procedures performed with respect to the firm's financial statements whether evidence was found of the existence of client money or custody assets held by the firm.

Reasonable Assurance CASS Audit

Key stages

Stage	Description
Planning	<p>Ensure planning is completed on a timely basis.</p> <p>Ensure Partner/Director involvement in planning is documented.</p>
Risk Assessment	<p>Risk assessment covering the firm's control environment, rule by rule risk and controls assessment and monitoring procedures.</p> <ul style="list-style-type: none"> - Adequate assessment of a firm's CASS culture and governance arrangements; - Documenting risks and controls identified by the firm; and - An assessment of how the firm's second (Compliance) and third line (Internal Audit) of defence assess the firm's compliance with the CASS rules. <p>Identification of higher / lower risks.</p>
Identification and Testing of controls (including IT)	<p>Test the controls that have been identified by the client.</p> <ul style="list-style-type: none"> - Impact of firm identified breaches on testing; - Importance of design assessment; - Importance of IUC (Information Used in the Control); - IT specialists and GITCs / interfaces / automated controls; - Reliance on work performed by the statutory auditor. <p>Conclusion on effectiveness of the control</p>
Compliance testing	Carry out testing
Conclusion of testing and forming the opinion	<p>Impact of control failures on the opinion</p> <p>Proportionality</p>
Reporting to those charged with governance	<p>CASS audit / governance committee reporting paper</p> <p>Management letter</p>

Planning

The planning phase of a CASS audit covers aspects of engagement set -up as prescribed by the FRC Standard including the following:

Stage	Considerations
Engagement Acceptance	<ul style="list-style-type: none">• Do you have a signed CASS engagement letter?
FRC Ethical Standards	<ul style="list-style-type: none">• Team / Partner / Quality Control rotation
Partner Led Planning Meeting	<ul style="list-style-type: none">• Are there any salient facts from audit planning which should be taken into consideration for CASS?
Planning Memo	<ul style="list-style-type: none">• Documentation of overall CASS Audit strategy• Include high risk areas for control testing and sample sizes
Resource Planning	<ul style="list-style-type: none">• Is there sufficient competence and experience in CASS to conduct the audit?
Firm Permissions	<ul style="list-style-type: none">• Do the permissions held corroborate with your understanding of the business? Are any permissions unused and if so why?
Reasonable or Limited Assurance?	<ul style="list-style-type: none">• Have there been any changes to business model in period?

Risk Assessment

The CASS Auditor is ultimately assessing the risk that there is a breach of the CASS rules that either individually or in aggregate would cause the CASS auditor to incorrectly express an unmodified opinion on either the systems and controls maintained by the firm or the firm's compliance with the CASS rules. This would include the failure to identify an adverse opinion.

The Standard identifies four components of this risk:

- Inherent risk (the risk of management not preventing non-compliance);
- Control risk (the risk that a breach of the CASS rules that could be significant will not be prevented or detected and corrected on a timely basis);
- Detection risk (the risk that the CASS auditor will not detect a significant breach of the CASS rules); and
- Evaluation risk (the risk that the CASS auditor will fail to measure or evaluate accurately the results obtained from its testing)

The CASS auditor is required to consider and address each of these risks through its work.

The CASS auditor needs to have a process for evaluating the regulated firm's control environment, the CASS risk assessment carried out by the regulated firm and the controls in place to mitigate those risks.

Testing of Controls

Once the relevant controls have been identified, they should be tested. The purpose of the controls testing is to determine whether, in aggregate, the systems operated by the firm are adequate to enable the firm to comply with the CASS rules.

Controls testing has several elements to it:

1. Assessment of the design of the control

- a) First, an assessment that the control is not designed effectively might be made based on information provided by the firm (such as a breaches log, monitoring reports or other reviews); or
- b) If there is no indication that the control is not designed effectively from already available sources then perform design assessment procedures.

2. If the control is designed effectively, test whether it has been implemented as designed.

3. If the control has been implemented, test whether it has been operating effectively during the period.

Testing of Controls

The five design factors

Design Factor	Questions	Examples
Appropriateness of purpose of control and its correlation to risk	<ul style="list-style-type: none">• Does the control mitigate the risk it is designed to?• Is the type of control appropriate for the level of risk?	<ul style="list-style-type: none">• Risk identified is that a corporate action is processed incorrectly, leading to custody assets being allocated to the wrong clients. Sign off on corporate action checklist – does not mitigate the risk. Review of allocation calculation/breakdown before corporate action is processed – mitigates the risk.• The risk is assessed as having a high likelihood of occurrence and significance of impact, but is mitigated only by a manual, detective control. The control is not correlated to the risk.

Testing of Controls

The five design factors (2)

Design Factor	Questions	Examples
Competence and authority of person(s) performing control	<ul style="list-style-type: none">• Does the control owner have the knowledge and understanding to operate the control effectively?• Do they have the necessary authority within the organisation to take the appropriate action required to operate the control effectively?	<ul style="list-style-type: none">• Shortfall funding – the individual has the CASS knowledge required to identify when a custody asset discrepancy requires funding• Discrepancy resolution – the individual has the authority to instruct the required teams to place correcting trades
Frequency and consistency with which control is performed	<ul style="list-style-type: none">• Does the frequency of the control make sense in the context of the process within which it sits?• Is the control performed in the same way every time it operates?	<ul style="list-style-type: none">• Fund manager statements are received monthly and so the reconciliation is performed and reviewed on a monthly basis• The reviewer checks the same fields and reperforms the same steps each time they perform their review of the reconciliation

Testing of Controls

The five design factors (3)

Design Factor	Questions	Examples
Level of aggregation and predictability	<ul style="list-style-type: none">• Does the control operate at the appropriate level of aggregation?• Is the information used in the control predictable enough to allow the control to be effective? This mainly applies to controls with a review element.	<ul style="list-style-type: none">• The external reconciliation is performed at a stock level, rather than at an individual client holding level• Large swings between surpluses and deficits would not be expected on the internal client money reconciliation each day – the surplus/deficit is predictable enough to allow a reviewer to identify an unusual amount
Criteria for investigation and process for follow-up	<ul style="list-style-type: none">• What does the control owner investigate and why, and is this appropriate?	<ul style="list-style-type: none">• Every reconciliation discrepancy must be investigated without undue delay• Monthly CMAR variances are investigated if they are above a documented threshold.

Testing of relevant controls

A control may be identified as being ineffective either because it has not be designed effectively or operated effectively and the impact of the control failing will need to be considered.

Alternative or mitigating controls should be investigated before concluding there is a controls deficiency. If effective mitigating controls are identified, then the CASS auditor should consider reporting to management that the firm's risk assessment miss identifies the relevant controls.

In both cases consideration needs to be given to whether the controls gap caused any breaches of CASS rules and reported accordingly.

Testing of relevant controls

IT Controls

IT Considerations

Common areas of consideration in relation to IT are:

- Systems holding data that is used to determine client balances;
- Systems used to perform reconciliations and identify exceptions or breaks;
- Interfaces between systems to feed data into the CASS reconciliations;
- Automated controls

Each CASS relevant system should have the following information considered:

- The general IT control environment operating (i.e. GITCs)
- Integrity of systems interfaces
- A deficiency in a general IT control environment that cannot be fully mitigated by other controls should be considered by the CASS auditor and are likely to result in a **breach** of systems and controls.

Testing of relevant controls – including IT Controls

IUC

Assessing whether there is any IUC is a critical element of assessing and testing the effectiveness of the control environment. As such IUC should be identified and assessed for completeness and accuracy. If IUC is not complete or accurate, it will have implications on how effectively the control can operate.

There are three key considerations for testing IUC:

Completeness and accuracy of source data	Report Logic	User entered parameters
<ul style="list-style-type: none">• Is the source data used in the control complete and accurate?• Take care if relying on work performed by the statutory audit team.• E.g. is the IUC source data system fed correctly by upstream systems?• E.g. is the reconciliation tool fed by a complete and accurate set of data from both source systems?	<ul style="list-style-type: none">• Is the extract from the source system complete and accurate?• E.g. is the report logic configured correctly to extract the data required?• E.g. is the reconciliation performed correctly, to give a complete and accurate list of exceptions?	<ul style="list-style-type: none">• If the report is manually extracted by an individual each day, did he/she select the correct day to run the report for?

Control deficiencies and deviations

It is a matter of judgement to determine whether a control exception is reflective of a deviation or deficiency.

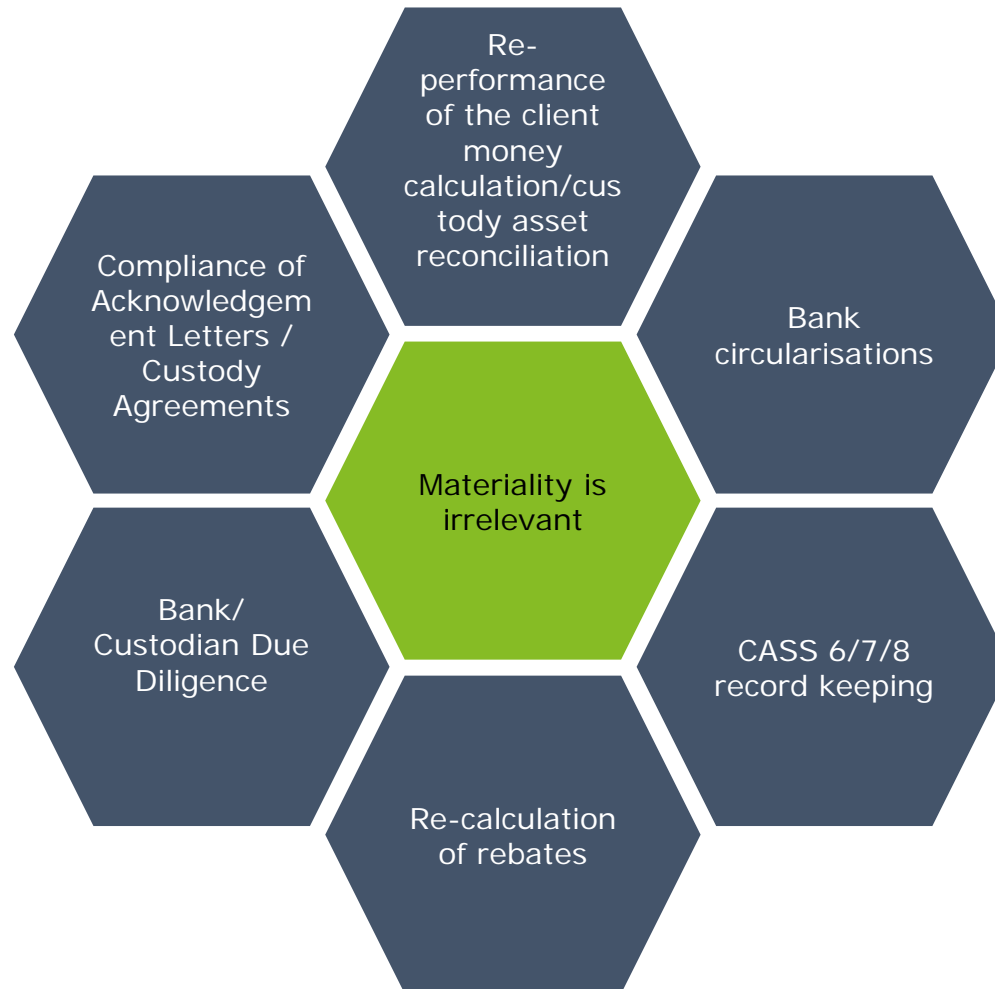
- A deviation may be a one-off failing for the control to operate as designed (e.g. through human error);
- A deficiency is a conclusion that the control is not effective.

Deviations and deficiencies (and control gaps) –

- should be reported in the breaches schedule **if the failing resulted in a breach of a CASS rule**. Nature and extent of testing to determine whether it resulted in a breach should be based on **judgement** and appropriately documented
- any deviation or deficiency should be considered for **inclusion in the management letter** issued to the firm
- even if there is **no rule breach** the failing should be evaluated to determine whether it is serious enough that it is a breach of the firm's requirements to have adequate organisational arrangements in place to protect client assets

Period end compliance testing

Examples





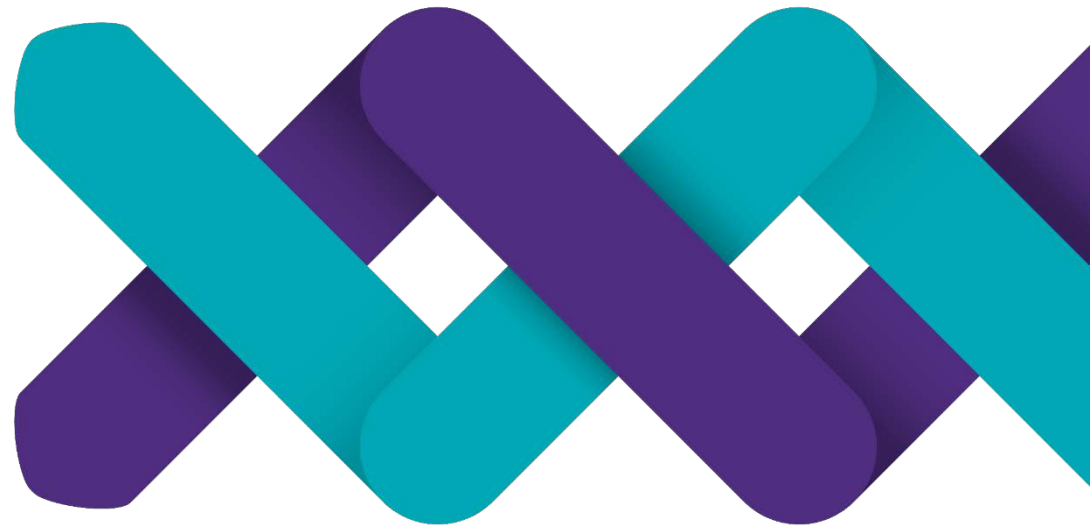
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Reporting



Drafting the report

Limited assurance or Reasonable assurance

- Use of correct template

Reasonable assurance opinion

- Compliance with the CASS rules during the period and
- Compliance with the CASS rules at period end

No breaches to report?

- rules are complex as a result, breaches are expected
- if no breaches:
 - **think what might you have missed?**

Reporting breaches

- **Breaches Schedule** attached to every reasonable assurance report
- FCA expects **every breach** of a rule to be reported
 - only those rules within the scope of the report
 - identified by the CASS auditor, the firm, or a third party

any breach => not a clean opinion

- **forget materiality**
- schedule includes a requirement for the firm (ie the regulated firm) to comment on each breach reported



What makes a good report of breaches

- **only breaches of relevant CASS rules**, ie not other rules
- **clarity** – needs to be understood by the reader, and given context, for example:
 - how frequent?
 - how many transactions affected?
 - when?
 - for how long?
 - what was the amount involved or at risk?
 - how many client bank accounts or securities involved?

Adverse/qualified – which opinion?

- SUP 3.10.9 and FRC CASS Standard provides guidance
- systemic or pervasive as opposed to isolated incidents
- consider aggregate effect of any breaches
- likely to be adverse opinion?

**Extent of loss if
the firm had
gone into
administration
while breach
persisted**

**Breach of
requirement to
keep proper
records of
client assets**

**Failed to carry
out or
incorrectly
carried out to a
significant
extent
reconciliations**

Adverse/qualified – which opinion? (contd)

adverse opinion ('did not')

- inadequate systems
- management does not understand its obligations

qualified opinion ('except for'):

- adequate systems
- human error or isolated events on a few occasions causes breaches

hybrid opinions possible (adverse/qualified/clean), eg:

- systems v period end
- client money v custody assets

inability to form an opinion

Modified opinion on Limited assurance engagement

- consider breaches leading to a modified opinion
- not uncommon for a modified limited assurance opinion
- Issues leading to client money being held:
 - Overpayments
 - Incorrect invoicing
 - Operational errors

Risk is high where client assets are held unprotected in a firm with no permissions!

Communicating deficiencies in internal control

- communicate to management deficiencies in internal control
- communicate in writing significant deficiencies in internal control identified during the CASS audit to those charged with governance

**Communicate
on a timely
basis!**

The statutory duty to report?

- a **duty imposed by law** on the auditor of an FCA or PRA authorised firm to report certain matters to the relevant Regulator
- HM Treasury regulations
 - *Financial Services and Markets Act 2000 (Communications by Auditors) Regulators 2001 (SI 2001 No. 2587), as amended*
- duty applies to the CASS 'auditor' as it does to the statutory auditor of the financial statements

When is communication necessary?

- **become aware** of 'matters' in capacity as auditor of:
 - *the authorised person, **or***
 - *a person with close links with the firm*
- **not required to search** for matters – but must act on those about which we become aware
- Report **as soon as practicable** – do not wait until CASS audit report submission

What 'matters' are we required to report?

We reasonably believe

- contravention of any relevant requirement that may be of **material significance** to the FCA in deciding what action it should take
- matters may be of **material significance** to the FCA re whether the entity satisfies or will continue to satisfy the 'threshold conditions'

What is 'material significance' to the FCA?

- **not same as audit materiality**, but
 - '... normally of material significance ... when, due either to its nature or its potential financial impact, it is likely of itself to require investigation by the regulator.'
(ISA 250, Section B, para 9 and FRC CASS Standard)
- **trivial matters** may be of material significance
- **cumulative** effect of matters

Document reasoning for decision to report, or not to report, a matter to the FCA



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Concluding remarks

Firm

- Do you know if you require a CASS audit?
- Do you have the correct permissions for the business you wish to undertake?
- Do you know which CASS exemptions you are relying on or that any waivers previously received are still valid?
- Have you documented a rule by rule risk assessment?
- Have you put in place sufficient training and governance arrangements for the scale of your CASS operations?

Auditor

- Do you have a documented audit approach that meets the requirements of the FRC CASS Assurance Standard?
- Does the team conducting the CASS audit have the appropriate knowledge of the FRC Assurance Standard, the CASS Sourcebook, the testing of controls and the testing of GITCs?
- Do you have a separate engagement letter for the CASS audit?
- Do you know when you need to submit a CASS opinion and what to do if you can't meet this deadline?

Remember there is no materiality and whilst the CASS Sourcebook and FRC Assurance Standard provide lots of information, the identification of breaches and management letter points by the CASS auditor is a matter of professional judgement.



Any questions?

Thank you for attending

Please take the time to fill out our short survey.

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