



**Financial Services Act 2008  
Guidance on Rule 5.18 –  
Clients’ Assets Report and Procedures (“CAR”)**

**Frequently Asked Questions**

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## **1. What letters and reports are required where part of a licenceholder's reporting period is covered by an earlier version of the Rule Book?**

In year one, all licenceholders, except those with a 31 December year-end, will have a reporting period which covers both Rule Books (2013 and 2016 versions).

The CAR came into effect on 1 January 2017 and consequently any submissions to the Authority relating to clients' assets from that date must be in the CAR format, regardless of whether clients' money and assets were regulated under the 2013 Rule Book. The CAR is merely a reporting mechanism and therefore there should be no issue with reporting on clients' assets using the CAR for the full year.

Licenceholders with a year-end on or after 1 January 2017 are not required to provide the Auditors' confirmations required under rule 5.20 of the 2013 Rule Book, in respect of clients' money and clients' investments.

If a breach is identified you should include the dual rule reference (as detailed in the 2016 Rule Book) unless the breach took place prior to 1 January 2017 (when the 2016 Rule Book came into effect), in which case only the 2013 rule number should be included.

## **2. Can the Authority provide any more information regarding the likely frequency of Auditor reviews?**

Rule 8.23 requires the CAR to be completed annually, while rule 5.18(1) provides flexibility on the required frequency of the auditor<sup>1</sup> review thereon.

The CAR is a new standardised clients' assets reporting mechanism and so the volume and significance of exceptions is currently unknown. Following the receipt and review of reports for licenceholders with year ends between 1 January 2017 and 31 March 2017, which are due to be submitted by the end of September 2017, the Authority will finalise and publish its Risk Based Approach ('policy') with regards the anticipated frequency of the independent auditor review. It is expected that this will be available by late November 2017 at the latest.

For transparency and to provide an early indication of the Authority's position, listed below are some factors that may form part of the Authority's policy:

- A backstop frequency. For example, all relevant licenceholders must have their CAR reviewed by an independent auditor at a minimum every [x] years;
- The highest frequency for independent auditor reviews would be annual\*;
- The Authority's risk and/or impact rating of licenceholder;
- Numerous and/or significant clients' assets breaches;

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<sup>1</sup> "Auditor" includes an accountant appointed by the licenceholder where the licenceholder controls clients' assets and has been exempted from the requirement to be audited by the Authority (Rule 5.1).

- Significant value of clients' assets held or significant volume of transactions (above [x] amount) during period;
- Numerous and/or significant adverse visit findings specific to clients' money and investments; and
- Auditor findings, either standard annual audit or CAR findings.

\*It should be noted that as the CAR is a reporting mechanism, it may be completed at any point during the year. On occasion, the Authority may require an auditor reviewed CAR at another point during the year. In such cases the Authority would liaise with the licenceholder and the auditor on timings for completion.

Licenceholders may choose to have their CAR reviewed annually by an independent auditor as part of their Corporate Governance arrangements, regardless of the Authority's requirements.

The Authority will ensure sufficient advance notice is provided to both the licenceholder and the auditor where CARs (subsequent to the 2017 CAR) are required to be reviewed by an independent auditor.

### **3. How has the scope of testing been determined?**

The CAR does not cover every rule requirement in Parts 3 and 4 of the Rule Book, but has been designed to focus on key risk areas and to keep external accountant/auditor costs to a minimum.

As detailed in Section 9 of the CAR, it is expected to act as a supplement to licenceholders' compliance monitoring programmes, which should map to all relevant rule requirements.

### **4. Do I need to include Nominee Bank Accounts within my scope of testing in Year One (the rules relating to Nominee Bank Accounts only came into effect on 1 January 2017)?**

Specific rules relating to nominee bank accounts only came into effect on 1 January 2017. Prior to that licenceholders were required under paragraph 2.7 of the Financial Services (Exemptions) Regulations 2011 to comply with the "relevant provisions of the Rule Book relating to client money". As this wording was considered ambiguous by some, specific rules for nominee bank accounts were incorporated into the 2016 Rule Book.

It is anticipated that, where nominee bank accounts were held, licenceholders would be in compliance with the client money rules. The Authority expects the CAR to incorporate tests on nominee bank accounts where they exist. If any issues arise from that testing, the Authority will consider these carefully and take into consideration the legislative position at that time.

For the avoidance of doubt, there should only be nominee bank accounts in the name of a Class 2 or 3 licenceholder's nominee company.

Any assets held by the licenceholder (or a nominee company) on behalf of client companies or trusts would be considered investment business which would require a Class 2 licence and be subject to the CAR.

## **5. Would investments held by trustees on behalf of trusts fall within the scope of the CAR?**

Investments held on behalf of trusts do **not** fall within the remit of the Clients' Assets Report ("CAR"). The testing required by the CAR is to assess compliance with the rules in Part 4 (Clients' Investments) of the Rule Book. Part 4 only applies to Class 2 and 3 licenceholders and therefore Class 4 and 5 licenceholders are not required to complete the clients' investments section of the CAR.

## **6. Do client companies with their own bank account fall under the remit of the CAR?**

If a company has its own bank account, it is responsible for its own money, and is not operating it for clients, but for itself. Therefore a client company bank account is simply that company's bank account and is **not** client money.

Equally, assets held by a client company are not considered "clients' assets" and therefore the company is responsible for these also and the CAR would not apply.

Whilst the CAR would not apply, the IOMFSA would expect a licenceholder's procedures to confirm what relevant oversight should be undertaken on these client company bank accounts and assets. For example, checks on transactions going through the accounts vs understanding of the activities of the company, and checks on reconciliations of assets. On the other hand, where money is held in a client bank account of a licenceholder, and that money is –

- trust money of a corporate trustee or private trust company to which the licenceholder provides services;
- other trust money (other than that for corporate trustees or private trust companies) where the amount of monies is not sufficient to warrant its own bank account; or
- money belonging to a client company which does not yet have its own bank account,

then it is clearly money belonging to third parties and thus clients' money deserving of the protections and limitations that surround use of these accounts.

Trust monies are subject to the CAR; trust money accounts are therefore required to be included within the CAR sampling procedures. However, assets held by a trust are not subject to the CAR.

## **7. Who would the Authority reasonably expect to undertake the performance of the procedures?**

The individual(s) preparing the CAR, and as a minimum the person providing oversight, should have a reasonably senior status within the organisation. They should have the relevant knowledge and experience and receive any training necessary to have a good understanding of the Rule Book, and specifically, clients' assets requirements. The Authority expects that individuals holding one of the following roles would be nominated to complete the testing:

- compliance officer;
- compliance administrator, with appropriate oversight;
- an accountant or bookkeeper; or,
- a manager/director

with sufficient knowledge of –

- (a) the Rule Book; and
- (b) the different types of relevant accounts (client money, trust money, relevant funds, nominee bank accounts and client company money), as appropriate for the type of business conducted and how they are operated.

As detailed within the CAR, suitable independence criteria should be met, although additional consideration is given for smaller licenceholders (see question 8).

## **8. Are there any concessions for smaller licenceholders?**

The sample size criteria in the CAR is designed to test a relatively small representative sample of the population of accounts and transactions and it is anticipated that smaller licenceholders will generally have a smaller population to test.

The Authority has received some concerns from smaller licenceholders who may not have sufficient resources in-house to meet the 'independence' criteria (Sections 4 and 8 of the CAR refer). In such cases, licenceholders may take one of two options; (1) outsource the work to a third party; or, (2) complete the procedures internally and acknowledge there will be an exception in the Auditors' Confirmation. Per footnote 4 of the CAR, failure to meet the independence requirement will be noted as an exception in the Auditor's Confirmation (Appendix D1 of the CAR), however, this does not mean that the Authority will automatically take further action.

## 9. What is the consequence should the auditor identify an error that has not been picked up internally?

The CAR is intended to provide value to both the licenceholder and the Authority. The odd exception (even if identified by the auditor but not the licenceholder) does not necessarily indicate that further action will be taken by the Authority. To ensure consistency of approach, all CAR exceptions will be reviewed by a central resource at the Authority.

In addition, it should be noted that the output of the CAR will not usually be considered in isolation. The Authority will also consider the licenceholder's compliance history, previous visit findings, breaches and any other relevant matters (specific to Part 3 and/or 4 of the Rule Book).

In certain cases, the Authority may:

- Require annual accountant/auditor reviews of the CAR (i.e. the highest frequency for external independent oversight);
- Require a third party (external accountant or compliance professional) report on the licenceholder's procedures and practices relating to clients' assets;
- Require third party (external accountant or compliance professional) completion of the CAR; and/or
- Perform an ad-hoc regulatory focus visit.

## 10. Is the purpose of this exercise to prevent fraud and, if so, could this not have been facilitated better via another means?

The CAR was not intended to and cannot prevent or detect all circumstances of fraud. The purpose of the CAR is to ensure that licenceholders have a satisfactory level of control over clients' assets. It is anticipated that the CAR will improve regulatory compliance in the area of clients' assets (Parts 3 and 4 of the Rule Book) and, when reviewed by the auditor, provide the Authority with a consistent and meaningful reporting mechanism.

One of the fundamental regulatory objectives of the Authority is; *“to secure an appropriate degree of protection for the customers of financial services providers, the reduction of financial crime and the maintenance of confidence in the Island's financial sector through effective regulation”*.

Accordingly, it is essential that licenceholders have proper policies and procedures in place to limit potential loss to clients due to theft and misappropriation of funds.

## 11. Please can you provide additional clarity regarding the required approach to sample testing?

The licenceholder is required to complete testing on a sample basis. The auditor is also required to complete testing on a sample basis, but on a sample of the licenceholder's sample, not a different sample. This is because the auditor is undertaking an independent review to ensure that the CAR is being completed appropriately.

The auditor is required to check at least 20% of what the licenceholder has sample tested. The Authority considers this to be quite a low volume of testing. Nevertheless, the CAR will improve consistency around client assets checks and testing and ensure there is focus on the right areas. For example, it should improve the level of comfort over the scope and consistency of testing including the requisite testing on samples of transactions going through client bank accounts.

Total per type of account:

- Total client bank accounts
- Total trust accounts

DO NOT add up the totals i.e. total client bank accounts and total trust accounts to determine the sample size, except for transactional testing where you can use the total receipts and payments through each client/trust/nominee account sampled. For the avoidance of doubt, this should be the total receipts and payments during the period of testing (usually one year) and not the total transactions per month.

Should a licenceholder prefer to undertake testing on a monthly basis, the Authority would view this as a separate compliance monitoring mechanism to the CAR exercise. The CAR stipulates minimum sample sizes, the licenceholder may complete more than this.

## 12. Once I have selected my sample, how many reconciliations should I review?

Paragraph 23 of the CAR confirms that one of the samples should be the last reconciliation in the period in question. Licenceholders have been provided with flexibility regarding the number of reconciliation samples selected for each account (See Footnote 10 of the CAR).

A licenceholder's approach may differ from account to account. For example, depending on findings, type of account and frequency of reconciliations.

See also sections 20 and 21 of the CAR regarding documentation and evidencing.

Regardless of whether a sample of reconciliations is tested (i.e. not 100%), the population of transactions must be the complete number of transactions through the sampled account during the financial period. Therefore a maximum sample size of 25 transactions per sampled account.

For the avoidance of doubt, the financial period should agree to the audited financial statements.

### **13. What are the Authority's expectations in respect of documented procedures?**

Preparation is key and licenceholders are expected to have a documented procedure in place in respect of the performance of the CAR. If time permits, we would also strongly suggest a practice test ahead of the year-end CAR. The Authority is willing to provide further guidance on its expectations and the completion of the CAR, as required.

Suggested areas for inclusion may include, but should not be limited to:

- Documenting and evidencing the work undertaken;
- Whether or not the individual selecting the sample should be the same as the person performing the testing;
- Sample selection techniques and the licenceholder's chosen approach (see question 13 below);
- Required skills and level of responsibility of individual selecting the sample and undertaking the testing, including any preliminary training that may be necessary;
- Conflicts of interest;
- Flows of information, including how issues will be escalated internally and the types of findings that would require immediate escalation; and
- On what basis, if any, 100% testing of client bank accounts and/or transactions may be more appropriate.

### **14. What sampling selection technique should licenceholders use?**

Definition of audit sampling: *"The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population".<sup>2</sup>* This definition applies similarly to the Authority's expectation of sample testing when performing the CAR.

The Authority has not stated any preference over the sampling technique that should be adopted. We would not expect anything too complex, but the selection procedure should be documented and it should ensure there is sufficient consideration of all relevant accounts including those with nil balances and dormant accounts, i.e. the population tested should be representative of the total population.

Consideration may be given to the number and value and types of transactions going through the accounts. Risks should also be factored in, such as the possibility of there being

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<sup>2</sup> ISA 530, paragraph 5 (a)



unused accounts subject to less frequent checks and therefore more open to the possibility of fraud.

Examples of sample selection techniques:

- Random selection - requires a way of naming or numbering all the client bank accounts, and transactions therein of those selected, and randomly select a number. Consider the advantages (simple, less bias) and disadvantages.
- Systematic – every “nth”
- Monetary unit i.e. value weighted
- Haphazard – no structured technique (not appropriate – increases the risk of deliberately avoiding certain items)

It may be worthwhile engaging with your auditor to agree appropriate sample selection technique(s) for your business.