Risk-Based Approach to Client Assets Reporting (Auditor Review)

1. Introduction

Changes to audit requirements in Part 5 (and to a corresponding requirement in Part 8) of the Rule Book came into effect on 1 January 2017, with the introduction of the Clients' Assets Report ("CAR"), to address risks facing the security of clients' assets[1].

The Authority prepared the CAR, which standardises the procedures performed, to support the annual Clients' Assets attestations provided to the Authority. The CAR is a compliance tool to be used by licenceholders (and their auditor) to improve identification, reporting and resolution of issues that may arise. As a result, it can assist licenceholders in identifying areas for improvement in their Clients' Assets policies and procedures. The CAR also assists us in understanding the extent and handling of Clients' Assets by licenceholders and allows the Authority to prioritise its resources.

Taking into account the implementation of new detailed procedures, the Authority has chosen to use a risk-based approach to permit periodic review by auditors no more frequently than annually. This enables us to continue to receive independent comfort from auditors and improve consistency of approach regarding the testing conducted, whilst recognising any potential cost implications for licenceholders.

The intention of the Authority is to keep the risk based approach relatively simple, and this is explained in sections 2 and 3 below; an example of how this works is shown in appendix 1. Licenceholders are not required to take any further action based on the information contained herein. It is for information and understanding only, and the Authority will communicate initial frequencies with relevant licenceholders. Thereafter, any changes will be advised to licenceholders as required. Should a licenceholder have any queries in relation to the frequency of auditor review to be applied to their business, they should contact their Relationship Manager in the first instance.

[1] Clients' Assets – generic term encompassing clients' money (including money held for clients in a nominee bank account), trust money, relevant funds and clients' investments held by the licenceholder or an eligible custodian. Clients' Assets do not include monies held in client company bank accounts and therefore client company bank accounts are not subject to the CAR procedures or reporting.

2. Frequency for auditor review

Frequency of Review	Number and Type of Risk Indicators (see section 3)
Annual **auditor review**	Two or more High Risk Indicators
Auditor review ***every other year***	1 High Risk Indicator, OR Three or more Medium Risk Indicators
Auditor review ***every three years***	Any other combination not covered above

Exceptions

The Authority reserves the right to exercise its discretion in setting the frequency of auditor review. In such cases the Authority will clearly explain the reasons for its decision with the licenceholder.

3. Risk Indicators

KEY:

General Client Bank account - GCBA	Specified Client Bank account - SCBA	Subscription and/or Redemption account - SRA
Nominee Bank account - NBA	Trust Bank account - TBA	Client Free Money account – CFMA
Client Settlement account – CSA	Clients’ Investments – CLINV	Relevant Funds - RF

	Risk Categories	High Risk Indicator	Medium Risk Indicator	Low Risk Indicator
1.	**IOMFSA Risk and Impact Assessment**	High Risk (Low, Medium or High Impact)	Medium Risk (Low, Medium or High Impact) OR Low Risk but High Impact	Low Risk (Low or Medium Impact)
2.	**Types of account used or activity undertaken (default to highest)**	CLINV CFMA CSA	NBA RF SRA TBA	GCBA SCBA
3.	**Number of accounts (any one or more – default to highest)** **Note: Not applicable for Clients’ Investments (Class 2 only) and/or Relevant Funds (Class 8 only).**	5 + GCBA 5 + SCBA 5 + NBA 11 + SRA 21 + TBA 2 + CFMA 2 + CSA	2 - 4 GCBA 2 - 4 SCBA 2 - 4 NBA 5 - 10 SRA 11 - 20 TBA 1 CFMA 1 CSA	0 - 1 GCBA 0 - 1 SCBA 0 - 1 NBA 1 - 4 SRA 1 - 10 TBA

	Risk Categories	High Risk Indicator	Medium Risk Indicator	Low Risk Indicator
4.	**Material breaches (supervisory judgement)** **Note: Takes into account *all* breaches not just those related to Clients' Assets**	Significant and/or numerous breaches in last three years	Default indicator for all licenceholders	None or very few non-material breaches in last three years.
5.	**Executive power**	Only 1 executive director	2+ executive directors	2+ executive directors, and at least 1 with a relevant accountancy qualification[2].

[2] See Appendix A of the Authority's Training and Competence Framework

Appendix 1: Example

IOMFSA Risk and Impact Assessment	Types of account used or activity undertaken	Number of accounts	Material breaches in last 3 years	Executive power	Recommended frequency for auditor reviews
Medium Risk, high impact	GCBA SRA	1 GCBA 11-20 SRA	No	2+ executive directors, and at least 1 with relevant accountancy qualification	Every other year

* To give an idea of approximate frequency of auditor reviews, it is anticipated that the majority of licenceholders will require an auditor review every other year. The Authority tested the proposed Risk-based Approach on a sample size of 21 licenceholders. It was determined that an auditor review would be required; annually for 9.5% (2 licenceholders); every other year for 61.9% (13 licenceholders); and, every three years for 28.6% (6 licenceholders) of the sample tested.