|  |  |
| --- | --- |
| **TECHNICAL CIRCULAR:** | **2/2023 [ΤC 2\_2023]** |
| **To:** | **All the Members of the Institute** |
| **From:** | **Auditing Standards Committee and Financial Services Committee** |
| **Date:** | **07 June 2023** |
| **Subject:** | **Illustrative auditor’s report pursuant to the requirements of the Directive for the safeguarding of client assets for Cyprus Investment Firms**  |

The Institute of Certified Public Accountants of Cyprus releases the illustrative auditor’s report in pursuant to the requirements of the Directive for the safeguarding of client assets for Cyprus Investment Firms as follows:

|  |  |
| --- | --- |
| **Illustration** | Assurance report to the Cyprus Securities and Exchange Commission (the “CySEC”) in respect of a Cyprus Investment Firm (CIF) pursuant to Paragraph 10 of the CySEC Directive DI87-01 of 2018 for the safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits. |

This circular replaces:

* Illustrative Agreed Upon Procedures report pursuant to the requirements of the Directive for the safeguarding of client assets for Cyprus Investment Firms, Technical Circular 3\_2022

**It is highlighted that:**

1. An appendix needs to be included within the Assurance opinion that includes a description of the main audit procedures performed. A template of the Appendix is provided at the end of the document.
2. A management letter, describing observations that have come to our attention during the conduct of our work, is encouraged to be produced and provided to the Board of Directors. This will include a description of the deficiencies in internal control and an explanation of their potential effects and sufficient information to enable the management to understand the context of the communication and any other matters we consider appropriate to communicate to the management. The existence of this Management letter shall be referred in the Assurance report under the “Other Matter” paragraph.

To the Board of Directors

[Engagement Party]

[City], Cyprus

**Independent Limited Assurance Report to the Cyprus Securities and Exchange Commission (the “CySEC”) on the safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits of [name of CIF] for the year ended [date]/period from [period start date] to [period end date]**

We were engaged by the Board of Directors of [name of CIF] (the “CIF”) to report on the suitability of the measures taken by the “CIF” pursuant to the provisions of Part II of the CySEC Directive DI87-01 of 2018 for the safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits (the “Directive”), for the year ended [date] /period from [period start date] to [period end date], regarding the organizational requirements under Sections 17(8), 17(9) and 17(10) of the Investment Services and Activities and Regulated Markets Law of 2017 (the “Law”):

(a) A CIF must, when holding financial instruments belonging to clients, to make adequate arrangements so as to safeguard the ownership rights of clients, especially in the event of the CIF's insolvency, and to prevent the use of a client's instruments on own account except with the client's express consent;

(b) A CIF must, when holding funds belonging to clients, make adequate arrangements to safeguard the rights of clients and prevent the use of client funds for its own account; and

(c) A CIF shall not conclude title transfer financial collateral arrangements with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations of clients.

**Board of Directors Responsibilities**

The CIF’s Board of Directors is responsible for maintaining adequate arrangements to enable the CIF to comply with the requirements of the Directive.

This responsibility includes designing, implementing and maintaining internal control ensuring that the CIF complies with the provisions of the Directive; designing, implementing and effectively operating controls to achieve the stated control objectives; selecting and applying policies; and maintaining adequate records in relation to the measures taken pursuant to the provision of the Directive.

**Our Responsibilities**

Our responsibility is to examine the measures taken by the CIF pursuant to the provisions of the Directive and to report thereon in the form of an independent limited assurance conclusion based on the evidence obtained. We conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE) 3000 (Revised), Assurance Engagements Other Than Audits or Reviews of Historical Financial Information issued by the International Auditing and Assurance Standards Board[.](file:///C%3A%5CUsers%5Caconstantinidou%5CDownloads%5CGSC_INTL_ASSSERVCS_05_IASM_0015%20%282%29.docx#_bookmark147) That standard requires that we plan and perform our procedures to obtain a meaningful level of assurance about whether the measures taken by the CIF pursuant the provisions of the Directive are suitable, as the basis for our limited assurance conclusion.

The procedures selected depend on our understanding of the measures taken pursuant to the provisions of the Directive, of the internal control system of the CIF and other engagement circumstances, and our consideration of areas where material misstatements are likely to arise.

Our engagement also included: assessing the appropriateness of the measures taken by the CIF pursuant to the provisions of the Directive, the suitability of the criteria used by the CIF in applying the measures taken and evaluating the appropriateness of the methods, policies and procedures, and models used.

Additional details of procedures performed can be found in Appendix 1 to this report.

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed.

**Our independence and quality management**

The firm applies International Standard on Quality Management 1, which requires the firm to design, implement and operate a system of quality management including policies or procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

We have complied with the independence and other ethical requirements of the International Ethics Standards Board for Accountants’ International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

**Conclusion**

Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that the CIF did not take suitable measures to enable it to comply with the provisions of Part II of the Directive for the year ended [date]/ period from [period start date] to [period end date].

*OR*

*Qualified Conclusion*

Based on the procedures performed and the evidence obtained, except for the effect of the matter(s) described in the *Basis for Qualified Conclusion* section of our report, nothing has come to our attention that causes us to believe that the CIF has not taken suitable measures to enable it to comply with the provisions of Part II of the Directive, for the year ended [date] / period from [period start date] to [period end date].

*Basis for Qualified Conclusion*

[…]

*OR*

*Adverse Conclusion*

Because of the significance of the matter(s) described in the *Basis for Adverse Conclusion* section of our report, the CIF has not taken suitable measures to enable it to comply with the provisions of Part II of the Directive, for the year ended [date] /period from [period start] to [period end date].

*Basis for Adverse Conclusion*

[…]

*OR*

*Disclaimer of Conclusion*

Because of the significance of the matter(s) described in the *Basis for Disclaimer of Conclusion* section of our report, we have not been able to obtain sufficient appropriate evidence to form a conclusion on the suitability of the measures taken by the CIF to enable it to the provisions of Part II of the Directive, for the year ended [date] /period from [period start] to [period end date].

*Basis for Disclaimer of Conclusion*

[…]

**Restriction of Use of Our Report**

Our report is solely for the purpose as set out above and for your information and is not to be used for any other purpose or to be distributed to any other parties without our prior consent in writing. This report relates only to the requirements of Sections 17(8), 17(9) and 17(10) of the Law and Part II of the Directive and does not extend to any financial statements or other financial information of the CIF.

**Other matter**

Pursuant to the terms of the engagement, we provided a management letter to the Board of Directors of the CIF, describing observations that have come to our attention during the conduct of our work. Our conclusion is not modified in respect of these matters.

[Name of audit firm]

Certified Public Accountants and Registered Auditors

[Address]

[Date]

**Appendix 1**

**Details of procedures performed**

Our procedures included among others the following:

|  |
| --- |
| **Procedures** |
| 1. **Clients’ funds are promptly placed in accounts as per par. 6(1) of Directive DI87-01 and distinguishingly separately from funds belonging to the CIF.**
 |
| Obtained listing of third parties which hold funds on behalf of clients. |
| Verified that these parties are permissible as per the requirement 6(1) |
| Establish that client funds are deposited in an account with a description that contains the term “client(s)“client(s)” or “client(s) account” or something similar. |
| 1. **The appropriate use of Payment Service Provides (PSPs) and Electronic Funds Institutions (EMIs) as per Circular C458.**
 |
| Checked whether the CIF maintains any client balances with PSP / EMIs by examining records such as QST\_CIF, reconciliations or through inquiries. |
| Checked whether the client funds received into PSP/ EMIs are transferred into clients' designated accounts held by the CIF, immediately after the clearing/settlement of the payment transactions and no later than the next business day |
| Checked that the CIF compensate the client's designated accounts by using own corporate funds before trading by confirming coverage from buffer maintained or other.  |
| Checked whether any reconciliation differences relate to funds deposited by the client(s) in merchant accounts and whether the respective amount was compensated to the clients' designated bank accounts no later than the next business day. |
| Obtained agreements with PSP / EMIs and checked for any provisions for rolling reserve / fix deposit requirements. |
| Checked whether funds equal to rolling reserves or fix deposits, are transferred from the CIF’s own funds in the clients account held by the CIF. This should be included as a receivable balance from the merchants in the CIF's statement of financial position. |
| Obtained agreement with the PSPs / EMIS and ensured that only the CIF is the contracting party and not any other third party or the Group entity |
| Obtained evidence that only the CIF’s employees (included in organizational chart) are authorized to manage PSP/EMI accounts (where clients’ funds are deposited). |
| Verified that the Company extends its Due diligence process to PSPs. |
| Accessed the CIF’s website and checked whether clients can be informed about the details of all PSPs offered by the Company (i.e., a list with the names of the PSP/EMI they cooperate, as well as the competent authority/country that supervise them) |
| 1. **Due diligence and diversification of institutions holding clients’ funds as per Circular C458.**
 |
| Inspected the CIF procedures in relation to the due diligence policy for banks to determine that that as a minimum it includes the following criteria:i. The bank where client assets are deposited is established and duly licensed.ii. Whether the bank will enable segregation of client accounts from those of the CIF’s to address the event of bankruptcy or other financial difficulty.iii. The bank is of good repute and has the expertise;iv. the capital of the bank;v. the amount of client funds placed, as a proportion of the bank’s capital and deposits;vi. the credit rating of the bank (if available); andvii. to the extent that the information is available, the level of risk in the investment and loan activities undertaken by the bank and its affiliated companies.viii. For banks in third countries, assessment and availability of deposit guarantee schemes to the underlying clients’ funds. |
| In relation to diversification check the below:I. Obtain the duly approved diversification policy which would include methodology how they diversify the funds among the banks considering the results of the due diligence assessment and procedures for compliance with the policy on ongoing basis. II. Where client funds are held with bank or a QMMF of the same group as the CIF, to procedures 7 and 8 of section 6: "depositing client funds".II. Check the application of the diversification policy. |
| **D. The compliance of the clients ‘funds deposited with a bank or a qualifying money market fund of the same group as the CIF with the limits as per Circular C458** |
| Where client funds are held with bank or a QMMF of the same group as the CIF, check that the client money held with such institutions do not exceed more than 20% of all the total client funds. In exceptional cases where the CIF does not comply with the 20% limit rule, refer to procedure 9 of section 6 "depositing client funds".  |
| In exceptional cases where the CIF does not comply with the 20% limit rule, the assessment proving that the exception provisions as per Directive 87/01 section 6 (Depositing client funds), par 3 and par 21 of C458 are met, and was communicated to CySEC. |
| Where the threshold stated above has been exceeded due to circumstances not attributable to the CIF’s actions or omissions check whether the CIF has made relevant arrangements (by the end of the next day that the issue was identified) to ensure compliance (i.e., transferred client funds to another third party). |
| 1. **The appropriate use of Title Transfer Collateral arrangements**
 |
| Obtained a signed confirmation from the Company’s Board of Directors/Head of Risk indicating whether the CIF uses TTCAs. |
| For retail clients ensured that:- No transfers from client to corporate accounts take place unless they relate to unrealized profits on the basis of reconciliation, when this is included in the agreement- For STP providers, the client funds transferred to the broker/ Liquidity provider sit at client designated accounts at the broker/ liquidity provider |
| For professional clients:- Obtained a random sample of written client agreements that cover at least:  (a)the terms for the arrangement relating to the transfer of the client's full ownership of money to the firm;(b) any terms under which the ownership of money is to transfer from the firm back to the client; and(c) (to the extent not covered by the terms under (b)), any terms for the termination of:(i) the arrangement under (a); or(ii) the overall agreement in (1).(d) The agreement shall not provide arbitrary transfer of all funds received from the client to the firm(e) The agreement describes the benefit to the client(f) The agreement does not represent a loan arrangement rather it is commercially done to cover current or future trading activities of the client- Client funds not under TTCA need to be kept in clients' designated accounts- Assess the procedures for the designation of elective professional clients (As per Law 87/(I), Second Annex, Part 2), and assess whether any of them entered into TTCAs. |
| 1. **Maintaining a buffer in clients’ bank accounts as per Circular C458**
 |
| Obtained the CIF’s written and approved policy, which includes the specific risks and amount that the CIF intends to cover and retain from its own funds into clients’ accounts with an entity of par. 6(1) of the Directive, justifying the amount of the ‘buffer’ kept. |
| Assessed whether the buffer at year end was in line with the approved policy. |
| 1. **The presence of Single officer for the safeguarding of client financial instruments and funds**
 |
| Enquired as to whether and which person or persons within the CIF have been assigned with responsibilities relevant to the safeguarding of client funds. |
| Obtained print screen from CySEC’s portal and checked that is maintained up to date with the details of their ‘single officer’. |
| Assessed this person’s relevant experience and authority / level within the CIF, and how the CIF justifies this person appropriateness (e.g., his/her work experience, academic/professional qualifications, any relevant seminars attended, other). |
| Enquired whether the CIF maintains documented policies and procedures on the responsibilities of this function, and that in these policies and procedures clearly states and describes the role of the ‘single officer’. |
| Checked whether the ‘single officer’ reports to senior management on a regular basis and stated in the report the frequency and type (eg. Report, email, meeting, etc) of such reporting for the reporting year. |
| Obtained evidence that the ‘single officer’ reviews and verifies the accuracy and completeness of the clients’ money reconciliation that is included in CySEC’s QST-CIF Form (i.e., Reconciliation Tab). |
| 1. **The Reconciliation of clients’ funds**
 |
| Inquired Management regarding the client asset reconciliation procedure between its internal accounts and records and those of any third parties by whom those assets are held (including details supporting existence of segregation of duties, frequency and formal approval).- Obtained the documented policies and procedures for the reconciliation process.- Assessed whether the frequency of reconciliation corresponds to the frequency of transactions (C458, p.31-33).- Selected a random sample of clients' assets reconciliations (including non-month end reconciliations, where applicable):- Checked that reconciliations are performed in line with the CIF's procedure and frequency, and that any reconciliation differences are promptly identified, properly explained and cleared as soon as possible (where clearance entails any shortfall to be topped up and any excess to be withdrawn).- Considered whether the necessary controls exist to ensure that all client accounts and third-party statements are reconciled properly at regular intervals. For this purpose, obtain a list of all accounts opened in third parties up to the period end, indicating the client accounts and whether they are used for holding funds or financial instruments. |
| Obtained evidence whether there is segregation of duties between the individual performing the reconciliations and the person(s) who maintained the records to be reconciled and are involved in the recording and moving of client assets. |
| Sent year-end confirmation letters to all third parties where funds and financial instruments are kept. Investigate any differences with the year-end reconciliation upon receiving of confirmation replies. |
| 1. **The presence of two persons as signatories as per C458**
 |
| Obtained a list of signatories for the accounts maintained with entities of par. 4(1) of the Directive and checked that there are at least 2 signatories for each account with combined powers. |
| Checked that none of the following persons act as signatories for the accounts maintained with entities of par. 4(1) of the Directive:a. the persons involved in the preparation of clients’ reconciliations; andb. the shareholders of the CIF if they do not have executive duties within the CIF. |
| 1. **The use of Clients’ accounts only for the CIF’s clients and not for the clients of the group.**
 |
| Obtained a transaction listing for the reporting period, reconciling opening balances to closing balances including deposits, withdrawals, purchases, sales, dividends, interest etc.Selected a random sample of transactions (money receipts and payments) and confirmed that they are paid in or out of the client bank account or merchant accounts with PSPs/EMIs no later than 3 business days after they have been received/need to be paid.Checked that the sampled receipts and payments relate to transactions with the CIF's clients only and not to clients of any other Group Entity that the CIF belongs to. |
| 1. **The appropriate use of margin facilities (credit facilities) granted to clients for executing traders involving cash settled financial instruments.**
 |
| Inquired if credit facilities were granted to the clients for executing trades involving cash settled financial instruments. Obtained a list of the credit facilities at year end and the respective collateral obtained by the CIF (in the form of cash or securities). |
| Assessed that no clients’ funds are used to provide the margin facilities  |
| Assessed that the clients’ financial instruments (which are obtained as a collateral) are not used for the CIFs own account or other clients of the CIF. |
| Confirmed that no debit balances of clients are included in the reconciliations. |