Thought Leadership Paper: Recording Cash Breaks & Handling Timing Differences for Client Money

The outstanding debate and the objective of this paper

The client money calculation rules in CASS require a CASS firm to carry out a reconciliation of its internal records and accounts. This is to reconcile the amount of client money that the firm should be holding for each of its clients (i.e. client money requirement), against the client money that the firm is holding in client money bank accounts (i.e. client money resource), as per the firm's internal records.

Whilst this process has been a core requirement of the rule book for many years, there remains significant differences in how the process is managed and how the rules have been interpreted from one firm to the next.

Most recently, there has been further debate about close of business records for the client money calculation. In particular the debate has been around whether external bank reconciliation breaks, which relate to the calculation reference date but which are identified on the day of the calculation itself, can be accounted for on the client money calculation.

The CASS rules* are very clear that only close of business internal records must be used for the client money calculation (i.e. without change and without reference to external records), however, we are aware that different approaches are still adopted by CASS firms. In addition, audit team opinions are also often divided on this subject.

> *CASS 7.15.13 R*
>
> In carrying out an internal client money reconciliation, a firm must use the values contained in its internal records and ledgers (for example, its cash book or other internal accounting records) rather than the values contained in the records it has obtained from banks and other third parties with whom it has placed client money (for example, bank statements).

In this Thought Leadership Paper, whilst we cannot comment on the differing approaches taken by CASS firms, we have set out some concepts and practices regarding the receipting and recording of cash taking into account both the CASS rules and available operational practices. The concepts and practices focus particularly on how cash breaks and timing differences could be managed if a firm wishes to ensure that its client money calculation is performed strictly using close of business internal records only.

Same day receipting and allocation

For cash coming into the bank account, it is important to ensure a swift and efficient receipting process such that all incoming monies are: **(i) receipted to the cash book; and (ii) allocated to an appropriate client ledger on the date of receipt**. Ideally this process would be as automated as possible, relying on technology and expectation based general ledgers to allow for straight through processing 'STP', rather than excessive levels of manual processing.

Once an item is receipted onto the cash book, a CASS risk exposure still remains as the funds have not been attributed to a client on the firm's books and records. Being able to allocate receipts to client accounts on the same day is therefore preferable. However, in reality, it is not uncommon for there to be receipts of funds which cannot be allocated to a client account due to insufficient details. Under the CASS rules**, these receipts should still be recorded onto the firm's books and records, and instead of being allocated to a client account should be recorded on omnibus ledgers set up for "unallocated" or "unidentified" receipts.

Unallocated and unidentified ledger accounts form part of the firm's books and records, and therefore these ledgers should be configured to feed into any client money requirement or client money entitlement calculations.

**CASS 7.13.36 R

(1) A firm must allocate any client money it receives to an individual client promptly and, in any case, no later than ten business days following the receipt (or where after the receipt of money it has identified that the money, or part of it, is client money under CASS 7.13.37 R, no later than ten business days following that identification).

(2) Pending a firm's allocation of a client money receipt to an individual client under (1), it must record the received client money in its books and records as "unallocated client money".

****CASS 7.13.37 R**

If a firm receives money (either in a client bank account or an account of its own) which it is unable to immediately identify as client money or its own money, it must:

(1) take all necessary steps to identify the money as either client money or its own money;

(2) if it considers it reasonably prudent to do so, given the risk that client money may not be adequately protected if it is not treated as such, treat the entire balance of money as client money and record the money in its books and records as "unidentified client money" while it performs the necessary steps under (1).

Establishing the concept of a close of business for your books and records

As noted earlier, the CASS rules say that the client money calculation must be performed using close of business internal records only (i.e. without changes being made because of post close of business processes and without reference to external records).

To achieve this, and to ensure the same day receipting process is not compromised, in practice a firm would actually need to define two significant times each day:

(1) **"TIME A"**: A cut-off time for the receipting process, i.e. the last time during the day when external bank feeds will be used to receipt money received into the bank account.
(2) **"TIME B"**: A cut-off time for internal processing to be completed i.e. the point at which close of business records can be created/finalised. For most firms this would usually be the time that all internal bookings and system processes are completed and the overnight batch-run processes can commence.

What does this mean for T[†]'s client money calculation performed on T+1[‡] and how does it ensure integrity of close of business records for the client money calculation

For cash receipts receipted same day, these cash receipts would have been committed to the firm's books and records on T, and would have been booked to specific client accounts, or have been booked to an omnibus unallocated ledger, or an omnibus unidentified ledger. Therefore, by design these receipts would be captured for the client money calculation performed on T+1, which is performed using the firms close of business books and records for T.

Any items received into the firm's external bank account after "TIME A" and before "TIME B", on T, would only be identified and booked onto the firms books and records on T+1 during the external reconciliation process. Therefore these items would not be included in client money calculation performed on T+1, which is performed using the firms close of business books and records for T. Under this method the firm would not adjust its calculation using external data from the bank reconciliation. Assuming "TIME A" is set at a reasonable time i.e. 5pm or 6pm, then any receipts on T, post this cut off, identified on T+1, can reasonably be considered as timing differences and should be

[†] Represents a UK working day
[‡] Represents the next UK working day after T

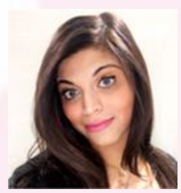
processed and recorded onto the firms books and records on T+1. As per the process on T, items would be first receipted onto the cash book, and would then be allocated to specific client accounts or be booked to an unallocated or unidentified ledger. Where breaks remain unallocated or unidentified the following day, they will feed that day's client money calculation using this method. (Note: Setting "TIME A" as a time too early in the day would question the integrity of the assumption that items post "Time A" can be reasonably considered as timing differences, and would not be in line with the FCA's principles for business).

If records used for the client money calculation performed on T+1 in reference to T, relate to the record created at "TIME B" on T, without any changes being made, and if the above concepts for external cash receipts and breaks are followed, then the firm's client money calculation can be concluded as being performed strictly using close of business internal records only.

Contacts

If you would like to discuss any of the issues raised in this paper further, or would like to discuss any area of the FCA's conduct rules or your own operational model, please get in touch directly by email or by leaving a message on our website.

www.rosediem.com



Nisha Sanghani
CEO & Managing Director

nisha.sanghani@rosediem.com

07930 323 758