

For the attention of Ms Catherine Horton

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BY EMAIL (consultation@frc.org.uk) and POST

Date
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Our reference
SVF/AVH

Your reference

Dear Madam

Consultation on the Financial Reporting Council's Audit Enforcement Procedure ("the Consultation")

We welcome the opportunity to respond to the Consultation and to comment on the proposed draft of the new Audit Enforcement Procedure (the "Procedure").

Taylor Wessing LLP is an international law firm with a specialism (amongst other things) in acting for the accountancy profession in relation to litigation and regulatory issues. Our team's experience includes acting on a significant number of regulatory investigations and civil proceedings including those relating to the audits of *BCCI*, *Barings*, *Equitable Life*, *Mayflower*, *JP Morgan Securities* and several ongoing matters with the Financial Reporting Council.

Overview comments

1. We note that the Procedure is intended to set out the mechanism for investigating breaches of a 'Relevant Requirement'. Included within the definition of a Relevant Requirement are requirements which will be set out in the Statutory Auditors and Third Country Auditors Regulations 2016 ("SATCAR 2016"). The draft version of SATCAR 2016, which was the subject of BIS's October 2015 Consultation, contained provisions which addressed the FRC's sanctioning powers as the Competent Authority. We note that the final form of SATCAR 2016 has yet to be published and, therefore, the nature and extent of the Relevant Requirements is not yet certain. We consider it would be preferable for the Procedure to be finalised after the final form of SATCAR 2016 has been seen in order that there is proper opportunity to ensure that the Procedure properly reflects and is consistent with its terms.

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2. Rule 4 sets out the threshold requirement of "*a good reason*" in order for an investigation to be undertaken. We would suggest that the guidance concerning this threshold requirement is clarified in order to ensure that matters where different reasonably held professional judgments can be held are not made the subject of disciplinary action. We also consider that the same threshold requirement should be included at the stages in the Procedure when consideration is given to whether a Respondent is liable for Enforcement Action, namely by the Executive Counsel pursuant to Rules 14/15, by the Enforcement Committee pursuant to Rule 21 and by the Tribunal pursuant to Rule 51. The inclusion of such provisions in the Procedure would ensure that a case which did not meet the threshold requirement of "*a good reason*" post investigation could not be pursued.
3. The Consultation, properly reflecting the content of the Audit Regulation and Audit Directive, is focussed on the responsibility of those undertaking statutory audits and we note that the FRC and the professional bodies are considering how far the FRC should continue to deal with public interest cases which do not involve statutory audit under the terms of the existing Accountancy Scheme. It would be helpful if the FRC could issue further guidance in order to clarify how the new regulatory regime will interact with existing disciplinary schemes and to outline the types of non-PIE cases for which the FRC anticipates it will assume responsibility and those for which the professional bodies will assume responsibility.
4. In our view it would be surprising and unfair, if individual members in business, especially those with responsibilities for Public Interest Entities (who are actually responsible for the preparation of the financial statements in question and who may on occasion be shown to have deliberately concealed the true position from the auditors) were subject to no regulatory sanction at all by the FRC.
5. It is unclear from the Consultation whether the work of the Audit Quality Review will continue in its current form. In particular, it is unclear whether the sanctions procedure currently applicable to the Audit Quality Review will continue or whether it is intended by the FRC that any failures identified through the AQR work will be dealt with under the Procedure. Given the importance of the AQR work, it would be helpful if the FRC were to provide clarification as to the likely position going forward.
6. In recent investigations concerning audit work undertaken by the Executive Counsel under the Accountancy Scheme, the engagement partner as well as the audit firm has generally been placed under investigation as a matter of course. The impact on an individual of being made the subject of investigation is considerably greater than that of a firm, especially in circumstances where investigations frequently take a number of years to conclude. While we recognise that there are cases where the engagement partner's conduct is deserving of sanction, we consider that it would be preferable if, under the Procedure, the firm were to be placed under investigation in the first instance in order that the role of the engagement partner can be properly considered so that an informed decision can be taken as to whether it would be appropriate for the individual also to be placed under investigation.
7. The Consultation states that the Procedure will apply to statutory auditors and statutory audit firms and suggests, therefore, that this will be the case even where a PIE is not involved. We note from the Consultation that while certain PIE matters might be the subject of investigation by the professional bodies (referred to in the Consultation as "*those investigations which do not arise out of the FRC's PIE Audit monitoring activities or referrals from other authorities*"), issues of sanctioning will be for the FRC to determine in accordance with the Procedure. It is not clear to us what sorts of PIE matters could

- form the subject of investigation by the professional bodies. The circumstances in which the FRC intends to apply the Procedure where a non-PIE audit is concerned are also not clear. We note that in many non-PIE cases the FRC will delegate regulatory responsibility to the professional bodies. We presume that the professional bodies will deal with such matters within their existing disciplinary frameworks. However, it would be helpful if the interactions between the FRC and the professional bodies which the FRC contemplates will take place in respect of disciplinary matters could be clarified.
8. In some disciplinary matters a Respondent might be prepared to agree the substance of an allegation but not be able to agree the extent of the sanction with the FRC. We consider it would be helpful if there were a mechanism to allow a Tribunal to determine the sanction without the need for the Enforcement Committee stage.
 9. The Consultation makes clear that the Tribunal will hear the allegation afresh. We consider that the Procedure should set out clearly that the hearing before the Tribunal is a de novo hearing.
 10. We note that the criteria for appointment to the Case Management Committee and the Tribunal and Appeal Tribunal Panel exclude auditors with current experience. We do not consider this to be helpful in circumstances where in many cases knowledge of current audit practice could help to improve the quality of disciplinary decision making. We recognise that this is a requirement of the Audit Regulation (insofar as Public Interest Entity audit work regulation is concerned) and would suggest that this issue is revisited whenever an opportunity arises. .
 11. In our experience investigations under the existing Accountancy Scheme have tended to be very slow. The time limits provided for within the Procedure only apply to the Respondent. We would ask that consideration be given to including time limits (which could be the subject of extensions in appropriate cases) for the FRC to commence and conclude their investigations in order that there is an incentive to ensure that investigations are undertaken within reasonable timescales.

Detailed comments on the proposed Procedure

12. Rule 6 provides that a Recognised Supervisory Body may exercise the powers set out in Rule 7 where an investigation has been delegated to it by the Conduct Committee/Investigation Committee. We mentioned in our general comments that the circumstances in which such delegation was anticipated to take place was rather uncertain and would benefit from further clarification. The Rule 7 investigation powers appear to derive from the Audit Regulation (Article 23). In circumstances where those powers concern the regulation of PIEs only, and in the absence of seeing the final text of SATCAR 2016 we would query the basis for the RSBs exercising those powers where they are investigating non-PIE issues.
13. Rule 7 is the first reference to the Executive Counsel. We would suggest that the rules explicitly explain that the Executive Counsel is appointed by the Conduct Committee/Investigation Committee to undertake investigations. We had understood that the role of Executive Counsel was to be renamed Director of Enforcement. If that is correct, then the rules should adopt the new title.
14. We presume that Rule 7(a) (and Rule 8(b)) is intended to require the provision of information in writing. We suggest that the position could be made clearer. The reference to "any audited person" in Rule 7(a) (and to "any Public Interest Entity" in Rule 8(b)) makes the power unreasonably wide in scope. We would suggest that the

information being sought must demonstrably be related to the matters under investigation. We would also suggest that the investigation powers generally be made the subject of proportionality/reasonableness requirements.

15. Under the Accountancy Scheme the FRC had power to interview Members. Rule 7(d) appears to be cast in terms which suggest that interviews are to be limited to the Respondent. Is it the intention that the FRC will be unable to interview anyone other than the Respondent? In circumstances in which the Respondent is a firm, then we consider that this power would require further clarification.
16. Rule 8(a) is a power which we understand derives from the Audit Regulation and, therefore, we suggest it should be limited to PIE matters only.
17. We consider that the Executive Counsel should be given an express power to extend the time limits set out in the Rules as they are likely to be insufficient in more complex disciplinary cases.
18. The Rules which concern Reconsideration in Part 8 are unclear and we would suggest that this Part would benefit from re-drafting. As presently drafted the Rules suggest that the FRC can reconsider a decision by the Tribunal to cancel a hearing. We do not consider it would be appropriate for there to be reconsideration in such circumstances and a Tribunal's decision should ensure finality.
19. We do not consider it would be appropriate, as is presently contemplated by Rule 77, to permit the Enforcement Committee, Chair or Tribunal, of their own volition, to amend the particulars of an allegation against the Respondent. It should be for the Executive Counsel to determine the particulars of the allegation and to pursue a case against the Respondent on that basis and for the Enforcement Committee, Chair or Tribunal to determine whether or not that case has been made out. It would not be a fair process if the decision making body, which should remain impartial, were also to exercise a quasi-prosecutorial role.
20. The Publications Policy appears to contemplate publication of Decision Notices in circumstances in which the Respondent might yet wish to appeal that decision. We consider that this would be contrary to the terms of Article 30c of the Audit Directive which specifically provides that publication should take place only after "*all rights of appeal have been exhausted*".
21. It does not appear that the capitalised defined terms are used consistently within the Procedure rules.
22. There are a number of internal inconsistencies within the Rules and cross-references which do not tie-up e.g. the reference to Rule 5 in rule 22.

If you have any queries or require any further information or clarification in relation to the comments set out above, please do not hesitate to contact Stephen Flaherty (s.flaherty@taylorwessing.com), Andrew Howell (a.howell@taylorwessing.com) or Julian Randall (jj.randall@taylorwessing.com).

Yours faithfully

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