

## Private and Confidential

Ms Catherine Horton  
Financial Reporting Council  
8th Floor, 125 London Wall  
London  
EC2Y 5AS

4 May 2016

Our ref: David Isherwood

Direct line: 020 7893 3228

Email: David.Isherwood@bdo.co.uk

By Email: Consultation@frc.org.uk

Dear Madam

### Consultation on the new FRC Audit Enforcement Procedure

We refer to the FRC's consultation paper on its proposed new Audit Enforcement Procedure ("the Procedure" or "new/proposed Procedure"), on which we are pleased to respond as an audit firm.

In response to the overall consultation questions, we have focused in particular on the fairness of the Procedure as balanced against the need to protect the public. In general, we welcome the more flexible and proportionate Procedure for dealing with less serious breaches of the Relevant Requirements. The proposed Procedure is in line with that of many other Regulators and appears to us to reflect the ARD requirements.

We also welcome the changes to the FRC publication policy and the advent of the discretionary announcement regime, which in relation to the initial phases of an investigation achieves a better balance in our view between the need for public transparency and fairness to Respondents. We do note that the Case Examiners will play a vital role in this regard; they will be required to demonstrate good judgement regarding each case (including in relation to the "good reason" test we comment on below) and have highly developed case management skills. Any weakness in this part of the system will undermine trust and risks damaging the effectiveness and efficiency of the overall system.

In terms of fairness and balance, we comment as follows on issues that we see arising from the consultation paper as well as the draft Procedure. We have tried to follow the order of the Rules with our comments, with our general points on the consultation sections included in sequence where appropriate as shown.

### Section 3 - Funding

We note that the FRC believes it would not be appropriate to maintain arrangements under which the income from fines is passed back to the profession (which will have a clear impact on the cost funding levies). If the accountancy bodies are to continue to fund case costs, the funding mechanisms need to ensure that there is no mismatch between FRC case costs and those actually recovered from Respondents. To the extent that there are any unrecovered costs (e.g. if the Tribunal only awards a certain percentage of the FRC costs) it seems to us to be reasonable to apply a proportion of any fine to this unrecovered costs element. This would ensure that any successful case costs are reimbursed in full and reduce RSBs' material cash flow disadvantages due to the time period between costs being incurred and costs being recovered. The accountancy bodies depend on member subscriptions and their capacity to cope with large, unexpected cash outflows which are not within their control is limited.

#### **Rule 4 - Decision to investigate**

Under Rule 4 there needs to be a “good reason” to investigate. The guidance at Appendix C sets out useful criteria in assessing whether a good reason exists or not. The good reason requirement is an important safety valve, given that the old procedure requires proof of the Respondent falling “*significantly below*” reasonable standards (which does not feature in the Procedure). It seems to us that the good reason test should also extend to the other phases of the Procedure, such as the decision by the Executive Counsel (14, 15) and the Enforcement Committee (21) on enforcement action and the Tribunal (51).

#### **Accountability of those responsible for the preparation of financial statements**

The consultation paper reveals that the FRC is currently considering whether it should continue to deal with accountants who are not auditors. We are strongly of the view that it should, recognising the primary responsibility of those within companies preparing the financial statements or otherwise engaging in conduct that could amount to misconduct. Our view is also strongly in favour of the FRC applying the new Procedure for accountants in practice so as to avoid the risk of auditors/accountants being judged by the different standards that exists in the Accountancy Scheme/new Procedure.

#### **Individual RI investigations**

The new Procedure is intended to apply to both Respondent firms and RIs. In our experience, the commencement of an investigation and the often lengthy period before the investigation is either discontinued or subject to enforcement, causes significant personal strain. Our view is that a more proportionate approach reflecting fairness to the individual, whilst still recognising the protection of the public, would be that the initial investigation phases be under a presumption that the Respondent firms (not individuals) be liable to enforcement action. If a decision to refer to enforcement is made, we would suggest that this is the appropriate juncture to then consider whether individual culpability and enforcement is required.

#### **7(a) and (b) - Information Gathering**

To keep information and documents focused on those relevant to an investigation, most regulatory powers include some form of relevance/reasonableness test. All documents on a statutory audit will “*relate to [the audit]*”, so it seems better to us to qualify the power to request information to that reasonably required to investigate the Allegations.

#### **Rule 10 - Time Limits**

In our experience, the 28 day time limit is generally too short to enable proper engagement on an investigation report, particularly where under the Procedure the FRC and firms are encouraged to use “*constructive engagement*”. Given the vast array of potential Allegations, it seems to us better to include the words “... (*or such other period as the Executive Counsel and Respondent shall agree*)”. By contrast, there are often considerable delays following submission of responses so it does seem to us that the Procedure could benefit from time limits to which the Executive Counsel should work for the various investigation phases (subject to a discretion to extend the time limits based on particular circumstances).

#### **Rule 67 - Reconsideration**

Under Rule 67 both the FRC and Respondent may, with agreement, reconsider: the decision to refer to investigation, any interim order, the decision to take no further action or to cancel a

hearing. 67(b) says that new allegations about the Respondent up to five years after such a decision (potentially a decision to take no further action), would trigger the right to reconsider the initial decision. Notwithstanding the need for agreement, it seems to us that this process could be unfair unless, for example, an interim order was, effectively, expressed to operate as a suspended sentence open to review upon any future breaches.

#### **Rule 77 - Amendments**

Whilst we recognise that the parties may wish to amend the particulars of an Allegation, it does seem to us that this should be on the application of either the Executive Counsel or the Respondent, not the Committee, Chair or Tribunal of their own volition.

#### **Appendix D and E - Auditors on Case Management Committee, Tribunal and Appeal Committees**

We note the limits placed on the number of auditors comprising these bodies and the requirement that auditors not have been in practice for three years. In our view, the technical expertise offered by auditors is important and may serve to reduce large costs of expert witnesses who are otherwise required to inform the Tribunal on technical issues. Actual and perceived outcomes would appear to be fairer for both the public and the Respondent (with less opportunity for appeal), with more auditors present on such bodies (and less restrictions on those that are eligible). If this cannot be achieved within the regulatory framework, we think the FRC should give careful consideration to the skill set of the Committees/Tribunals to ensure as far as possible that relevant and up to date audit expertise is available.

#### **Appendix G - Sanctions Policy**

The proposed policy is a very comprehensive guide to the matters to be considered in determining sanctions. However it does not include any benchmark financial penalties (or ranges of financial penalties) or recommended non-financial sanctions for different categories and levels of breach. The consultation paper notes that *“the integrity of any decision to impose a sanction and the particular sanction proposed by either the Executive (Enforcement Division) or the Enforcement Committee will be protected threefold: 1. by all decision makers (Executive, Committee and Tribunal) following published Sanctions Guidance;....”*

It is not clear whether the referenced *“Sanctions Guidance”* is additional to the *“Sanctions Policy”* published as Appendix G.

We appreciate that any decision on the sanction for any individual case is ultimately a matter of judgement and will be based on the specific facts and circumstances. However, in the absence of published benchmark sanctions for different categories and level of breach, it will be difficult to judge the operation of this very important safeguard to the integrity of the decision to impose a sanction. There is a risk this could result in a loss of trust in the sanction setting process. We note that RSBs currently publish benchmark sanctions in their sentencing guides and indeed sentencing tariffs are published as part of the criminal justice system. We believe the publication of benchmark sanctions is best practice and is important to ensure consistency of application of the Sanctions Policy. It will help ensure transparency in sanctioning and maintain public trust in the Audit Enforcement Procedure. It will also assist in relation to the *“constructive engagement”* process in that both the Decision Maker and the Respondent will be clear on the likely sanction with appropriate discounts etc, which the Procedure outlines.



Ms Catherine Horton  
Financial Reporting Council  
4 May 2016

We hope you find these comments useful and we look forward to the final published version of the new procedure in due course. Should you wish to discuss any of the above, or have any further questions, please do contact David Isherwood on 0207 893 3228.

Yours faithfully

*BDO LLP*

BDO LLP