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Your Ref AADB THE ACCOUNTANCY SCHEME REVIEW

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For the attention of Anna Colban

11 April 2008

Dear Sirs

**Consultation Paper: The Accountancy Scheme Review**

We welcome the opportunity to comment on the Accountancy and Actuarial Discipline Board's (AADB) consultation paper The Accountancy Scheme Review (Consultation Paper). Appropriate and proportionate enforcement of high quality audits is extremely important for market participants, the professional bodies and their members. While we welcome some of the proposed amendments proposed in the consultation Paper, in a few instances, we are concerned that the proposals do not achieve appropriate enforcement solutions.

**Relevant conduct**

In assessing whether a case needs to be brought, the AADB proposes to move away from a test of misconduct to a test for "relevant conduct". We are not convinced there are any persuasive arguments for a change to the current test. Cases dealt with by the AADB should be confined to those of the highest profile, where there is prima facie evidence of serious shortcomings in the work or behaviour of defendants, and where the consequences of a successful prosecution are likely to be severe. The majority of less serious cases should rightly be dealt with by the disciplinary processes of the participants and we do not understand the consultation paper's reason for aligning the definitions of inappropriate behaviour or conduct. Specifically, we are very concerned that some of the components of the definition of "relevant conduct" in section 6.6 are vague and set the test at an inappropriately low level. The four components that cause us concern are:

- "likely to damage public confidence in the accountancy profession"
- "fails to comply with any relevant law, charter, bye-law, regulation or guidance"
- "fails to comply with applicable accounting, auditing, ethical or other standards"
- "falls short of the standards of professional conduct, competence or integrity reasonably to be expected of a member of Member Firm"

The first element appears appropriate in principle, but if the damage arises from a small error of judgment, or from overlooking a fine point in a standard, this should not be allowed to generate an investigation or tribunal which otherwise could be perceived as reacting to a desire to attach blame to a party purely because the case has a high profile.

The later three elements of the relevant conduct test would vastly increase the potential workload of the AADB, which as the consultation paper notes, has limited resources. We believe that these three elements would lead to a danger that the AADB would be deflected

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from investigating the most serious cases, which is not congruent with the aims of the AADB.

There would also be a serious danger that almost every complex audit would, in theory at least, fall within the new definition of relevant conduct. These audits involve thousands of hours of input from large audit teams across a number of countries and it is inconceivable and unrealistic to expect that every paragraph of every auditing standard would be complied with. This does not of itself invalidate the overall high standards of the audit work and documentation nor the audit conclusions reached. We believe the proposed change in the tests of relevant conduct would lead inevitably to many of the best audit partners and staff declining to take on the most complex or difficult audits. We are also concerned that a lower test for bringing a prosecution will encourage box-ticking by preparers and auditors to the detriment of financial reporting and audit quality. These dangers are not addressed by the consultation paper.

While considering the proposals to remove the ability of a successful defendant to recover costs from the AADB, we have had cause to revisit the test to be applied in deciding whether to instigate a tribunal. Ultimately the sort of cases being brought by the AADB, if proven, will have fundamental and serious consequences for the individuals and firms concerned. The gravity of the consequences of a guilty verdict on the careers of the individuals concerned in our view requires that the burden of proof is significantly higher than a "balance of probabilities".

#### **Disciplinary or criminal investigations**

A critical issue is the interaction between disciplinary investigations and criminal investigations, particularly in the light of the new criminal offence of audit conduct set out in the Companies Act 2006. The consultation paper is silent on this matter, which is unfortunate in an area where clarity and transparency would benefit all parties. A lack of clarity in this area could lead, for example, to defendants or witnesses becoming less willing to cooperate with AADB investigations, delays in proceedings or even the risk of double jeopardy to defendants. If it has not already done so, the FRC might consider it to be appropriate to commission in-house guidance to direct how to proceed.

#### **Costs of successful defendants**

We acknowledge that the Financial Reporting Council (FRC) occupies a delicate position as the primary regulator for the UK accountancy profession. In that regard the FRC could be seen to be fulfilling the roles of "prosecutor", "judge" and "jury". We agree that the FRC's role in this regard is currently appropriate. However it is incumbent on the AADB to implement appropriate controls to ensure equitable disciplinary procedures.

We also believe that the AADB should not be, or appear to be, deterred from bringing forward a prosecution of a case in which there is strong prima facie evidence of misconduct. However, we do not believe that protecting the AADB from ever having to pay the costs of a successful defendant is the only, or indeed, an appropriate mechanism for overcoming such a problem.

An important incentive for the AADB to ensure that only appropriate disciplinary cases are "prosecuted" is the right of a successful defendant to recover costs. This is one of the primary measures that maintains the balance and fairness of the UK's disciplinary system. The primary argument put forward by the AADB for requiring successful respondents to bear their own costs rests on the premise that at present the AADB is constrained from instigating a tribunal by the potential award of costs against it if the AADB is unsuccessful, and that the AADB does not have the resources to compete with those of the larger audit firms.



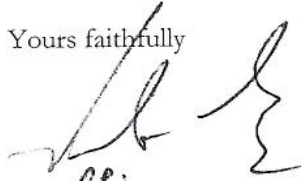
However, there is a wide range of potential defendants, including small audit firms, audit partners who have left their firm and individual directors or former directors who have neither insurance cover nor any corporate resources to pay their costs of defending themselves. Therefore, we do not believe this cost argument can be applied by the AADB fairly and in a principled manner across all firms and members who fall within the scope of the Accountancy Scheme. The AADB's proposed solution seems to us unfairly onerous on the larger audit firms, but is even more unfairly onerous on those individuals and audit firms who do not have significant or any corporate resources with which to defend their positions.

In our view the AADB has not made sufficiently persuasive arguments for the proposed solution and it would be inappropriate to remove the potential for an award of costs against the AADB for successful respondents. Indeed, the principal arguments held out to support the removal of "loser pays" (public interest in a regulator being able to bring cases which need to be brought, and that the regulator need not fear ruinous costs if he loses) is in our view a sound argument in support of government funding. One solution would be for the FRC to explore ways to ring-fence cost awards against the AADB, or revert to stakeholders, so that awards against the AADB would hit neither the FRC's budget nor the AADB's running costs.

In passing we note that the AADB has presently only two courses of action available to it. It can either take the results of an investigation forward to a tribunal, or it can decide not to proceed to a tribunal. A third option might be to allow the AADB at the completion of the investigation stage to privately admonish the audit firm concerned and to require it to improve standards (which could be monitored). This might be appropriate where there is evidence of misconduct but where this does not in itself warrant proceeding to a tribunal.

If you have any questions on this response, please contact Steve Maslin (phone: 020 7728 2736; email [Steve.Maslin@gtuk.com](mailto:Steve.Maslin@gtuk.com)) or Nick Jeffrey (phone: 020 7728 2787; email [Nick.Jeffrey@gtuk.com](mailto:Nick.Jeffrey@gtuk.com)).

Yours faithfully



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## **Appendix 1 - questions for consultation**

Question 1(a): Do you agree in principle with the proposal to require a tribunal to find that any allegations proved amount to "Relevant Conduct" before making an adverse finding?

**Grant Thornton response:** Yes.

In passing, we note that an act of misconduct is referred to in the Consultation Paper only in the context of the disciplinary tribunal, but that 6.7 should be read to mean also that Executive Counsel may deliver a complaint to the AADB if the allegations constitute an act of misconduct (ie Executive Counsel and the disciplinary tribunal make decisions by reference to the same definition).

Question 1(b): Do you agree with the proposed definition of "Relevant Conduct"?

**Grant Thornton response:** No. In addition to comments in the covering letter, we make one observation of detail. "Relevant Conduct" is defined, inter alia, as a failure to "...comply with any relevant...guidance...". In our view reference to "guidance" is inappropriate.

Question 2: Do you agree with the proposal for the Board, where it considers it relevant, to direct Executive Counsel to make preliminary enquiries before it reaches a decision on whether to investigate a matter?

**Grant Thornton response:** Yes.

Other regulatory bodies make good use of powers to conduct preliminary enquiries. For example, the Financial Reporting Review Panel is widely acknowledged to be a proportionate regulatory body, in part due to the manner in which it conducts its preliminary enquiries.

We believe that appropriate preliminary enquiries should help the AADB decide whether or not there is a prima facie case to answer, but these preliminary enquiries should not replace the more formal investigation conducted by the ICAEW.

Question 3(a): Do you agree with the proposal that an independent committee will review the formal complaint and the evidence in support of that complaint before the formal complaint is served and a disciplinary tribunal is appointed?

**Grant Thornton response:** Yes.

Question 3(b): What are your views on the proposed composition and the three main functions of the DDC?

**Grant Thornton response:** The composition of the DDC appears appropriate. In keeping with other areas of governance, the performance and scope of the DDC's work should be reviewed by the AADB on a periodic basis.

Question 4: Do you agree with the proposal to provide for the Board to reduce the scope of an investigation on request by Executive Counsel?

**Grant Thornton response:** Yes, we believe that this is an important improvement and another feature that will help the AADB to minimise unnecessary costs in the long term.



Question 5(a): Do you agree with the proposed test to be applied by Executive Counsel in deciding whether to deliver a formal complaint?

**Grant Thornton response:** No. In view of the damaging consequences to a defendant that arise from the delivery of a formal complaint, we believe that the test should be considerably stronger than "realistic prospect".

Question 5(b): Do you agree with the proposed two-fold test to be applied by the DDC?

**Grant Thornton response:** No. We believe that the test should be strengthened from "realistic prospect".

Question 5(c): What are your views on the factors to be included in the Desirability Criteria?

**Grant Thornton response:** Of the considerations in section 6.27 of the consultation paper "Seriousness of the allegations" should be part of the test at earlier stages in the AADB process than consideration by Executive Counsel. It is unfortunate that proposed Desirability Criteria did not form part of this consultation paper.

Question 6: Do you agree with the proposal that an independent Convener will appoint tribunals?

**Grant Thornton response:** Yes, we believe that this is an important improvement in the tribunal process.

Question 7(a): Do you agree that a balance must be maintained between fairness to a successful respondent and ensuring that the regulator is not constrained from bringing proceedings because of the possibility that costs may be awarded against it?

**Grant Thornton response:** No. We agree that the regulator should not be constrained, but there must also be appropriate balances in place to ensure that only appropriate cases are brought by the AADB. Concern about the award of costs against the AADB is not in itself a sufficiently strong argument to conclude that costs must be borne by a successful respondent. To require a successful respondent to settle their own costs might be entirely unfair, for example where the wisdom of bringing forward the case to tribunal has been seriously questioned. In our view the issue could be resolved by ring-fencing the award of costs against the AADB. It would seem appropriate for the AADB to approach government or other stakeholders for assistance on this matter, and in our forthcoming response on the FRC's funding proposals we will reinforce this point.

Question 7(b): Do you agree that the proposal in respect of costs assists in maintaining that balance?

**Grant Thornton response:** No. In our view, in some instances it would be unfair and unbalanced to require a successful respondent to bear their own costs.

Question 8(a): Do you agree with the proposal to remove the tribunal chairman's casting vote?

**Grant Thornton response:** Yes.



Question 8(b): Do you agree with the proposal that, where there is an equality of votes in respect of any motion, that the motion should not be carried?

**Grant Thornton response:** Yes, on the grounds that the gravity of being found guilty of misconduct requires a degree of proof that in our view is not met by a split vote of tribunal members.

Question 9: Do you have any comments on the costs and benefits (including any quantification) of the proposals to amend the Accountancy Scheme, as set out in the Board's preliminary Regulatory Impact Assessment?

**Grant Thornton response:** The AADB justification for requiring successful respondents to bear their own costs rests entirely on the premise that at present the AADB is constrained by the potential award of costs against it, and that the AADB does not have the resources to compete with those of the largest four firms. The paper is silent though on small audit firms and on individuals. The proposals on award of costs are onerous enough on larger audit firms, but the impact assessment does not address the issue of the individual who might also be subject to a tribunal.

