

Anna Colban

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**From:** Howard, Jane [Jane.Howard@rpc.co.uk]  
**Sent:** 27 March 2008 13:19  
**To:** Anna Colban  
**Subject:** AADB Consultation Document January 2008

**Attachments:** RPC\_DOCS1-7818057.DOC.DRF



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Dear Anna,

I have been considering the proposals put forward in the Consultation Paper and had hoped to respond to you in the format requested. However, due to work and leave commitments, coupled with the fact that I will not, after today, be in the office again until after the Consultation period closes, I hope that you will forgive our more informal approach.

Our primary comments on the paper are set out in the attached article (that we are about to publish in our regular publication "Accountancy Update"). As you will see, our main concerns relate to costs and the proposed new definition of "Relevant conduct". As far as the later is concerned, it would seem sensible for some sort of overarching threshold or materiality test to be built into the definition - absent which, the AADB could (inadvertently) find itself obliged to consider some relatively inconsequential breaches of rules and guidelines.

Yours sincerely,

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## Extract from RPC Accountancy Update March 2008

**The Accountancy and Actuarial Disciplinary Board (AADB) has launched a consultation on changes to its Accountancy Scheme, which are proving controversial. Jane Howard considers the proposals**

The AADB's consultation document setting out proposed changes to its Accountancy Scheme has caused quite a stir (to put it mildly!).

Key changes proposed by the Board include:

- Restriction of the Tribunal's discretion to award costs against the Board to circumstances where there has been "misfeasance" on the part of Executive Council, the DDC or any person engaged to assist with the investigation or tribunal
- A change to the definition of conduct subject to disciplinary action and the replacement of "misconduct" with the term "Relevant Conduct"
- A new power to conduct preliminary enquiries before making a decision to investigate
- Changes to the procedures relating to the decision to lay complaints, including the formation of a Disciplinary Decisions Committee ("DDC")
- A two-tier test to be applied by the DDC before a matter proceeds to a disciplinary tribunal - an evidential test and a desirability test
- New procedures to appoint tribunal and appeal tribunal members by an independent Convener.

Mike Fogden, Chairman of the AADB, believes that *"The changes it is proposing will further strengthen the disciplinary process in public interest cases"*. If it gets its way, the Board will be able to reprimand professionals for breaches of 'guidance', as well as standards. (Until now, only a standards breach would have been actionable).

The new scheme requires the agreement of the accountancy bodies who are no doubt being lobbied hard by their membership as the end date for comments draws near. However, unlike disciplinary investigations for non-public interest cases (which are operated by the accountancy body to which the relevant member or member firm belongs), the AADB operates independently of the accountancy bodies (albeit it is largely funded by the accountancy and actuarial professions). The Board can begin an investigation into the conduct of a member or member firm of one of the participating professional bodies if it considers that:

*"The matter raises or appears to raise important issues affecting the public interest in the United Kingdom and the matters needs to be investigated to determine whether there may have been an act of misconduct"*.

Should the matter proceed, the investigation will typically culminate with a public hearing and, under the current regime, the Tribunal has a discretion to order the AADB to pay the legal costs of the respondent in defending a complaint that is, ultimately, dismissed.

Thus far, the proposed new rules relating to the recoverability of costs have proved to be the main cause for concern amongst accountants. If adopted, the defendant will have little hope of recovering its costs even if successful in its defence. The Financial Reporting Council (FRC) has hit out at firms who argue that the AADB is trying to create an environment *"in which it cannot*



lose", arguing that it should not fear 'ruinous costs' in bringing cases which need to be publicly heard.

If the AADB is successful in amending its rules, the concern is that it will be free to act unreasonably, without any fear of costs, unless it is found guilty of 'misfeasance'. The threshold for establishing "misfeasance" is extremely high (based on the definition to be found in the consultation document itself) and is only likely to be met in extreme circumstances. In essence, it would require costs claimants to show the exercise of a power intending to cause harm, and/or acting in the knowledge of (or with reckless indifference to) the illegality of an act whilst knowing (or with reckless indifference to) the probability of causing harm, i.e. that there has been some deliberate and dishonest use of office. It would be equally difficult to prove that the AADB had acted "*vexatiously, frivolously or unreasonably*", if the test currently used by the Financial Services Authority were to be used instead.

While the FRC suggests that the possibility of adverse costs awards in unrestricted circumstances can inhibit the ability of a regulator acting in the public interest to bring disciplinary proceedings, the converse may also be true; namely, it could encourage them to bring unmeritorious claims with the full knowledge that they will be immune from having to pay the costs of the member subject to those proceedings (as it had to do in the case of *Mayflower*). There can be little doubt that the *Mayflower* case was the catalyst for this particular proposal. There, the AADB had to pay a £1 million costs award to PWC and David Donnelly (former FD of the collapsed bus manufacturer) when its case against them failed (costs that the FRC had, for some reason, failed to budget for).

The FRC fanned the flames of an already indignant profession by characterising the current situation as one of David and Goliath - commenting that large firms and their PI Insurers have "*almost unlimited resources*" to fight any disciplinary case.

Whilst the costs issue is but one of the proposed reforms, some commentators have suggested that it could lead to broader disillusionment with the tribunal process, characterising the proposed changes as offensive to 'natural justice'. (Firms were not keen on the Joint Disciplinary Scheme (JDS) which also denied Defendants' costs.)

Should the new scheme be adopted as proposed, it will be more important than ever to ensure that PI cover includes adequate cover for the costs associated with disciplinary proceedings of this sort.

The other main area of concern in the consultation document is the proposal to replace the concept of an "*act of misconduct*" with that of "*Relevant Conduct*". This will need to be further refined as (absent some sort of materiality or threshold requirement) it could (in theory) capture minor transgressions of laws, bye-laws, regulations or guidance, as well as more serious ones. This cannot surely be what was intended. If adopted as proposed in the consultation document, the AADB could (inadvertently) find itself duty bound to consider insignificant departures from standards and guidance, thus diverting it from its overarching objective.

Fortunately, the document does contain a number of proposals that should prove beneficial. The proposal that the Executive Council could make "preliminary enquiries" before committing to a full investigation (for example) seems eminently sensible. This would enable some cases to be reviewed and dismissed at an early stage with only limited (if any) reputational damage being done to the firm or individual under investigation.

Likewise, the proposal to empower the Board to reduce the scope of an investigation could yield potential costs savings (assuming of course that this power is exercised more frequently than it is in the litigation context!). Under the current regime, the Board may increase the scope of an investigation to include new matters discovered during the course of the investigation; it cannot reduce it.

Formal responses to the consultation are requested by 11 April 2008.

