

RESPONSE TO THE FRC: 10 January 2012

FROM: Mira Makar MA FCA LRAD ARAD

Relevant Experience: 29 years

corporate recovery; turnarounds; decade plus Coopers & Lybrand, London, tax, treasury, financial instruments, corporate, M&A, cross border, compliance

decade plc CEO, FD, deputy chairman, professional services, business transformation, risk management, compliance and infrastructure delivery projects, telecoms (mobile/fixed), banking/insurance (product manufacture/wholesale/retail sales); public sector (central government)

public company principal investor

witness to matters under regulatory review and consequences of the absence of law enforcement

"Joe Public"

1. The case for FRC reform

Do you have any comments on the case for FRC reform as set out in this document?

Currently, the FRC has a range of regulatory activities which extend beyond its core mission of supporting the effective functioning of the capital markets and UK business; it is structured in a way that is over-complex and insufficiently understood, with a risk that, in aggregate, regulation by its seven different bodies will be over-burdensome; is insufficiently independent from the accountancy professional bodies in its supervisory and disciplinary role in relation to audit; and is equipped with a range of sanctions and procedures which might be disproportionate in some cases.

Reform is needed to:

1.1. reinforce the FRC's independence from those it regulates;

1.2. improve its efficiency and effectiveness; and

1.3. rationalise and minimise the regulatory burdens on market participants.

It is not intended that reform should introduce further regulatory processes which impact significantly on business. However, to achieve our aims some proposed reforms will require changes to the legislative framework. An impact assessment has been prepared and is available at <http://www.bis.gov.uk/Consultations>. We are committed to reducing the cost to business associated with FRC regulation and will consider carefully any opportunities for cost reduction identified through responses to this consultation.

Yes I have comments, as follows:

At present, the FRC does not support inward investment into the UK since it does not systematically identify and address the reasons equity funds and others do not invest: investors coming to the UK looking for a regime that is apparently less onerous than for example in the US, find that we "have no regulation", the balance

sheets of targets are flaky and evidently so, and leave.

Second our small to mid cap markets have been through consolidation, funds have been through redemptions and the AIM market has lost credibility and all but disappeared, with other smaller markets ephemeral.

Third the FRC has carried out no published statistical review with a view to comparing the responsibility of the public accountant, for example, at the time of the USM with the experience under AIM, and the increased responsibility in investor protection where there is a NOMAD compared with the main market. Financial disasters as BetonSports, listed July 2004, collapse July 2006, are not publicly investigated, and the auditor responsible held to account. AIM companies are required to maintain a web site whilst they exist, it goes when they do; and basic investor and market protection, such as a prospectus lodged at Companies House that survives the demise of the company, does not exist. Neither the auditor nor licensed/regulated individuals are held to account.

Without such fundamental and basic accountability, an investor in the UK market; fledgling, AIM, main, over the counter, or any other is little more than a blind speculator.

Fourth, the argument emanating from a "fear of regulation" is both unsound and ill-conceived and is in the same class as "fear" that one of the Big Four fails. The perception of "burden" emanates from the fact that financial statements and prospectuses/fund raising documentation, has, for at least a decade, become well beyond comprehension by anyone with years of experience, and not read by anyone else, on the grounds of being impenetrable and requiring translation by someone else. For at least a decade letters of engagement require teams of lawyers internal and external to review let alone agree and practice areas in the firm supplying the services of the auditor issue their own letters, leaving it to the "client" to work out where the differences are.

Fifth, the documentation that is now the "norm" is all about risk shifting; exceptions reporting, that "buries" the risk; and finding ever more complex routes to avert accountability.

Sixth, there appears no-one at the FRC or anywhere else who has undertaken an assessment of the damage of (i) the trend shift to US style lobbying as a mechanism to influence government; legal reform; and regulation;(ii) the financial devastation consequent on the Limited Liability Partnership Act 2000; (iii) the dilution of law enforcement by police; DTI (however re

2.	<i>Do you agree that the proposals for reform will bring benefits and increase the effectiveness of the FRC?</i>
	<p><i>The aim of the reforms, therefore, is to:</i></p> <ul style="list-style-type: none"> <i>2.1.consider how better to focus the FRC’s activities where it can make the biggest difference, taking into account its core mission</i> <i>2.2.create a simplified structure which is easily understood by the FRC’s stakeholders</i> <i>2.3.reinforce its independence from those it regulates</i> <i>2.4.ensure it has the powers to respond proportionately and effectively where problems are identified.</i> <p><i>It is our intention that building on its current strengths the FRC should emerge as a body that is more effective, more joined up and capable of addressing the big issues, has proportionate sanctions available to it and is able to target its resources to greatest effect.</i></p>
	<p><i>However, the FRC’s powers (currently exercised by the POB) in relation to its oversight of the Recognised Supervisory and Qualifying Bodies (RSBs and RQBs) is limited to bringing about any change by influence or through statutory enforcement powers which, if they are to be considered proportionate, should only be exercised in serious cases.</i></p> <p><i>1.16 The Government and the FRC consider that a more graduated range of powers would sharpen the speed and quality of the responses of the recognised bodies to recommendations. Furthermore, the lack of proportionate powers gives a perception that the oversight body is too dependent on the goodwill of the regulated bodies to bring about change and reformed powers would establish more firmly the independence of the FRC from those being regulated.</i></p> <p><i>1.17 At the same time the current disciplinary procedures can take too long to conclude, even when all parties agree there has been misconduct and on the appropriate disciplinary action. The Government and the FRC consider that, in appropriate circumstances, the FRC should be able to agree sanctions with firms and individuals without referral to a public hearing before a tribunal. An individual or firm subject to disciplinary proceedings will still have the right to a public hearing before an independent tribunal.</i></p> <p><i>1.18 The Government and the FRC also consider that inquiries targeted at issues of corporate governance and reporting following the collapse or near collapse of a public interest entity - using the FRC’s reformed powers as proposed in this document - would have the advantage not only of informing its stakeholders but also of ensuring that any referral to enforcement or disciplinary procedures is appropriate.</i></p>
3.	<i>Do you have any comments on the consultation stage impact assessment?</i>
	<i>It is important to recognise that the Government and FRC are not proposing significant additional regulatory processes. In fact, the proposals are deregulatory. The accountancy profession has and uses some of the proposed powers already. The proposals in this document are designed to extend those powers to the FRC to ensure they can be exercised</i>

	<p><i>independently rather than to extend supervision into new areas. The proposals on sanctions are designed to enable the FRC to apply lesser remedies more cost effectively, through a more straightforward process.</i></p>
	<p>The fear of regulation is misplaced. The absence of law enforcement is the concern. The AIM market was created to facilitate capital and less regulation; its demise shows what happens when there are no rules and the market is open to speculators.</p>
<p>4.</p>	<p><i>An investment focus for the FRC's activities</i> <i>Should the primary focus for regular FRC activity in relation to codes and standards for corporate governance, accounting and auditing, and for monitoring the quality of corporate reporting and auditing, be publicly traded companies and large private companies?</i></p>
	<p>4.1. No. The focus of the FRC must be law enforcement, ie (i) securing fast and efficient public prosecutions, in regard Consumer Protection from Unfair Trading Regs 2008; FSMA 2000; Companies Act; Limited Liability Partnership Act; technical support for BIS criminal prosecutions; (ii) properly identifying its customers (company directors; BIS; OFT; trading standards; police; SFO; HMRC; the public) and its supply chain (those providing experience, expertise, labour, witness evidence, market intelligence) and defining its remit regularly to ensure that no-one, especially Joe Public, is met with "we don't do that"; (iii) supporting the OFT in providing help to the public who are victims of greed and dishonesty, when it manifests itself in those it regulates; (iv) identifying threats to the public from industry trends, such as lobbying by the industry for self interested change, such as the creation of LLP's, that has turned auditors reports into a game of roulette in the courts, with internal lawyers and external lawyers creating litigation risk shift products with the speed of ingenuity not seen since the wheel was invented; similarly lobbying for "privilege" to be extended to tax advisers rather than issuing technical guidance to the industry/profession and the public pointing out the narrowness of the application of privilege and the extent of abuse (v) investigate and prosecute on the basis of individuals (rather than be left dealing with a corporate); refuse to have any contact or dealings with internal or external lawyers; and refuse legal or third party representation in Tribunals; (vi) be ready to inform the Business Secretary, Vince Cable, that the use of lawyers, as Tim Dutton of Herbert Smith, to describe, PwC's defaults as an "honest error", effectively puts PwC above the law, and that for directors, and in criminal law, "reckless" does not distinguish between honest and otherwise: until the LLP partners are held to account in the same way as the clients who rely on them, and fines continue to replace prosecutions, no law enforcer will have any credibility with the market/public,</p>

and the industry will continue to be regarded as self serving, greedy, and ruthless

<http://www.telegraph.co.uk/finance/newsbysector/supportservices/8995981/PwC-fined-record-1.4m-over-JP-Morgan-audit.html>

<http://www.telegraph.co.uk/finance/newsbysector/supportservices/8976059/PricewaterhouseCoopers-faces-up-to-1m-fine-over-JP-Morgan-Securities-audits.html>

FSA secures convictions in first criminal market abuse case



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FSA/PN/091/2005

18 August 2005

The jury in the case of R v Rigby, Bailey and Rowley at Southwark Crown Court has today convicted:

- Carl Rigby, 43, on one count of recklessly making a statement to the market which was misleading, false or deceptive in a material particular, contrary to Section 397 (1)(c) of the Financial Services and Markets Act 2000 (FSMA)

On Tuesday 16 August, the jury convicted:

- Gareth Bailey, 36, on one count of recklessly making a statement, promise or forecast which was misleading, false or deceptive in a material particular, contrary to Section 397(1)(c) of the FSMA 2000.

and acquitted:

- Alistair Rowley, 43, on all counts.

Margaret Cole, FSA Director of Enforcement, said:

"This case demonstrates the FSA's willingness and capability to take all necessary action in pursuit of its objective of maintaining market confidence, including prosecuting criminal charges against individuals where appropriate."

The individuals were charged with one count of making a statement to the market knowing it to be

	<p>misleading, false or deceptive in a material particular, under s.397 (1)(a) of FSMA and with one count of recklessly making a statement to the market which was misleading false or deceptive in a material particular contrary to Section 397(1)(c) of FSMA</p> <p>Sentencing for Carl Rigby and Gareth Bailey will take place on 7 October 2005.;</p> <p>(vii) carry out regular self assessment on results of audits; for example, the FRC some 6-7 years ago spotted a pattern that audit firms promote on the basis of cross selling achievements rather than being a “safe pair of hands”: this will continue until there is a disastrous result; therefore it is in the interest of the consumer, buyer of shares and services of LLP’s etc that the FRC ought, as a matter of policy, to proactively intervene, in cases in which this is an issue, and bring about that change that will stop the practice. Self assessment will monitor the time from spotting a problem to final change; (viii) actively promote disclosure that achieves parity between those audited; the auditor; the policeman (BIS prosecution); in particular LLP partnership agreements must be disclosed as plc articles etc; individuals remuneration and terms on a team must be part of the report and accounts together with resume of credentials and experience; and all insurance contracts must also be reportable; (ix) consider the special responsibilities of the auditor of an auditor in particular the obligation to inspect the books and records in regard risk shift contracts and off balance sheet financing structures, use of underwriters and third parties; (x) be able to authoritatively inform BIS about the significance of exceptions reporting and other important practices, such as the meaning of “an auditor shall report”; an “independent” audit; an assurance report and why it is said that an auditor can close his eyes and sign and no-one will be the wiser; (xi) be able to have a view on practices that can raise an eyebrow, such as the creating of “Associate” status to non accountants, and the undermining effect of business decisions, such as creating networks to generate business, rather than prioritizing the terms of a licence of full members, both a dilutive effect and one that doubtless undermines the credibility of the licensing bodies; (xii) be able to dispel false alarms, such as the audit of a going concern forecast is anything more than agreeing numbers to underlying records, that the auditor must do routinely and that auditing processes for managing risk is anything more than an internal controls compliance audit; (xiii) retain lines of communications with licencees in all walks to be able to mobilize for data gathering, analysis, trend spotting, and source of informed and experienced labour; (xiv) be able to reliably assure government ministers that were the audit part of one of the Big Four to fail, it would cause no more than short term disruption, and draw parallels with the scare-mongery over date changes and IT systems failures over the millenium. Consider role in transition if any; (xv) consider role if any in financial melt down or other crises; (x) consider those parts of the civil service code of conduct that can usefully be incorporated into staff T’s & C’s, along with performance self assessment aligned to the objectives of law enforcement and support for those in charge of the governance of enterprises that rely on the industry and pay the levy.</p>
<p>5.</p>	<p><i>Is the definition of large private company for this purpose – an annual turnover of £500m or more – appropriate?</i></p>
	<p>No wholly irrelevant. The issues for the audit of a bank are the same as for the audit of a sweet shop. The risks are greater with a bank because the use of computerised</p>

	<p>systems means that trainee auditors may have never ticked records to ledgers, or spent days on bank reconciliations, etc. The effect is manifest in that a whole generation is now trained to work from secondary records which effectively means there is the risk nobody looks. This is like an employment lawyer working from guidance rather than law or tax agents from HMRC website rather than law and statements of practice.</p>
6.	<p><i>Should the scope of the FRC's accountancy disciplinary arrangements be narrowed to cover the quality of work and conduct of accountants in relation to the preparation and audit of annual reports and other reports for the capital markets, leaving other cases of potential misconduct to the professional bodies?</i></p>
	<p>No. There is no difference between an assurance report which is direct reporting, or audit and one that is assertion based (non audit). The capital markets are no different to any other markets, in terms of appetite for speculation, and the need for the assurance provider to LOOK at the underling contracts; UNDERSTAND what one is looking at; and say whether what the underlying true position is reflected in the reports.</p>
7.	<p><i>Are there other areas of activity from which the FRC could appropriately withdraw?</i></p>
	<p>All those where it does not have experienced staff and cannot call on external help.</p>
8.	<p><i>Do you agree that streamlining the FRC's governance and structure will bring the benefits described?</i></p>
	<p>The only difference that can be made, especially in the short term, is to seek to employ retired/retiring staff from BIS and Insolvency service who have the experience and expertise to understand law enforcement and to emulate their ethos. Trading standards, whose decision making is run by lawyers, it seems, appears to have abdicated responsibility for law enforcement of LLP's (they have no option under consumer protection) and the FRC needs to assist in putting life into them. The FRC needs to reinvent itself, come to terms the fact that sanctions after the event "ambulance chasing" is useless and will always be met by techniques of "kicking into the long grass"; risk shifts; isolating the miscreants until they retire/resign; and separating those with knowledge from those fronting the defence. It needs to be centre stage assisting the Competition Commission, showing that the unit labour cost of an auditor ought properly to be the same as the policeman, ie civil service pay scales; that "deregulation" has meant that there is a dearth of audit experience and opportunity, ie serious deskilling; that polarisation has created insurmountable barriers to entry; that the banking administrators have had to pay bank staff to teach them to do their work, a measure of overcharging that has been occurring, and evidence of the need for personal licenses demonstrating experience</p>

	and skill; and that the shift from a regulated audit function to massive profitable businesses that swamp their clients in financial clout, means for all practical purposes, that we do not have an independent audit function, and capital will continue to flee.
9.	<i>A streamlined structure</i> <i>Do you have any comments on the proposed reformed FRC governance and structure?</i>
	The correct structure will follow a "reinvention" of the FRC: generally, silos are a bad idea; external networks are good; and self assessment essential.
10.	<i>Independent supervisory and disciplinary arrangements</i> <i>Do you agree the FRC should be given powers to determine and require a recognised supervisory body to impose proportionate sanctions, subject to appropriate safeguards, on an audit firm and/or individual auditor in respect of poor quality work?</i>
	No. It ought to be active in law enforcement and not worry about sanctions, fines etc that nobody cares about. The derisory fine on PwC over JPMorgan, can only be viewed as an opportunity for fees for Herbert Smith to get PwC off the hook.
11.	<i>If not, what are your concerns and how do you believe this issue should be addressed?</i>
	Very simply. Fines are not a substitute for prosecution. An auditor is a supplier to a director and when the supplier does not perform honestly he must be prosecuted. This is not when the matter is historic, but whilst it is happening and damage can be stopped.
12.	<i>Do you agree the FRC should have the ability to make its own rules for the independent disciplinary arrangements without being required to obtain the agreement of the professional bodies?</i>
	It is absurd to think a body disciplining has to ask permission. Ethical Standard 1 on integrity is sufficient in all likelihood for most cases. The FRC must address the fact that licencees must be able to have somewhere to report matters of public concern and misconduct, and be prosecuted from prosecution and disciplinary. Unless victims and witnesses can be protected, including from the harassment of wrong-doers, the FRC will end up having no credible raison d'être.

13.	<i>If not, how would you propose the FRC demonstrates its independence in this regard?</i>
	<p>It is not about demonstrating anything to anyone; it is about punching weight, getting results and supporting the business secretary and CIB grapple with dishonesty and greed; the SFO say (14 December 2011) they know what economic criminals look like (everyone else but greedy and dishonest) but as they are organised, they can do nothing about it. This is just like the FSA jailing the AIT directors, simply for allowing themselves to be bullied into pre close statements by their sponsor, and bullied into not resigning.</p> <p>The FRC will start to become independent when it refers to accountants as suppliers (to directors) and the licensing bodies as just that.</p>
14.	<p><i>Should the FRC be able to take more proportionate, nuanced action against a Recognised Supervisory or Qualifying Body and therefore be given a wider range of enforcement powers against the recognised bodies? In particular, should the FRC be able to:</i></p> <p><i>! Issue an enforcement order, requiring the body to take specified actions by a specified date, without the need for a court order?</i></p> <p><i>! Impose conditions on continued recognition as an RSB or RQB?</i></p> <p><i>! Impose fines on an RSB or RQB and if so, at what level?</i></p>
	<p>It should assist law enforcers and not promote a new industry for litigators short of work.</p>
15.	<p><i>Should the Companies Act and the AADB Schemes be amended to allow for the conclusion of cases without public hearings where appropriate and where agreed by the parties?</i></p>
	<p>No. It is not in the public interest to do anything behind closed doors.</p>
16.	<p><i>Proportionate regulation</i></p>
	<p><i>Do you agree that the FRC should develop a mechanism to enable it to undertake supervisory inquiries into matters of concern, either of individual market events or wider market interest, initially building on its current powers to secure information?</i></p>
	<p>It should have the results but not duplicate considered research. It is not a research institute.</p>