ICAS RESPONSE

FRC CONSULTATION – AADB SANCTIONS GUIDANCE TO TRIBUNALS

11 July 2012

Background

The Institute of Chartered Accountants of Scotland (ICAS) received its Royal Charter in 1854 and is the oldest professional body of accountants in the world. We were the first body to adopt the designation "Chartered Accountant" and the designatory letters "CA" are the exclusive privilege of Members of ICAS.

ICAS is a professional body for 19,000 Members who work in the UK and in more than 100 countries around the world. Our CA qualification is internationally recognised and respected. We are a Recognised Qualifying Body (RQB) for statutory audit. We are also a Recognised Supervisory Body (RSB). We have over 230 audit-registered firms, of which five firms are involved in the audit of public interest entities and fall within the scope of the FRC's Audit Inspection Unit (AIU).

All 19,000 Members and our audit-registered firms fall within the current scope of the Accountancy & Actuarial Disciplinary Board (AADB).

Consultation

ICAS welcomes the opportunity to comment on the consultation paper produced on sanctions guidance for AADB Tribunals. We recognise that the FRC is going through a period of significant change and we strongly desire that the UK has a regulatory system which is robust and fit for purpose.

Before responding to the detailed consultation questions, we would wish to make some general comments on the proposals.

The AADB consider those cases which raise serious issues affecting the public interest in the UK and which fall within the scope set by the FRC from time to time. At present, such cases must involve an alleged act of misconduct and meet a "public interest test", but may otherwise relate to both statutory audit and non-statutory audit work. Cases which fail to meet this public interest test usually fall outside the AADB scope, and are considered by the relevant Participant Body under its own disciplinary arrangements.

It would seem clear that, under the proposed financial penalty formula, certain regulatory or professional failings could be capable of vastly different financial sanctions dependent upon whether the "public interest test" is met and which body has disciplinary jurisdiction. This will only lead to further confusion and inconsistency. Against this background, it is of some concern to ICAS that each of the Participant Bodies may be expected to adopt a similar financial penalty regime at some point in the future (in much the same way that there was an expectation for the bodies to follow the lead of the AADB and to adopt an open hearing policy for disciplinary cases).

The future adoption of such a severe penalty formula based solely on turnover or gross personal earnings would surely undermine the purpose of professional discipline and regulation.

Key Points

1. ICAS recognises the regulatory trend towards consistent decision-making and sanctions guidance. As a general principle, we support the FRC's desire to provide greater clarity to those individuals and entities that are subject to proceedings before an AADB Tribunal.

2. Notwithstanding this position, ICAS has a number of strong concerns over the proposals outlined in the current consultation paper.

3. ICAS believes that all Tribunals should retain discretion in decision-making, meaning that any sanctions guidance to be introduced should not be overly-prescriptive in nature,

4. We are having difficulty reconciling the apparent punitive nature of some of the current proposals with legal authorities which state that the primary purpose of professional disciplinary arrangements should be to protect the public interest.

5. With regard to the proposal to impose financial penalties with reference to the financial resources of members and size and financial resources of Member Firms, ICAS is concerned that the focus is on deterrence at the apparent expense of proportionality.

Consultation Response

Q1. Do you agree with the Board's objectives and approach to sanctions guidance.

There is a growing regulatory trend towards consistent decision-making and sanctions guidance is as important for the AADB as it is for the tribunals established by each of the Participant Bodies. In this respect, we fully support the FRC's desire to provide greater clarity to those individuals and entities that are subject to proceedings before an AADB Tribunal.

Q2 Do you agree that Tribunals need a clear framework for sanctions which reflects the nature of its cases and the wider context in which the accountancy profession operates today?

We wholly agree that Tribunals ought to have access to sanctions guidance but we also believe that the discretion of the Tribunals should remain unfettered in such cases. The prescribed nature of the proposals set out in the consultation document in relation to financial penalties does not seem to provide sufficient flexibility.

It is important that the proposed sanctions framework outlined in the consultation is directed at a very specific group of qualified individuals and firms within the accountancy sector. The disciplinary powers of the AADB only extend to the members of the Participant Bodies (and only several are Recognised Supervisory Bodies for statutory audit purposes). Moreover, in the wider context, there is a significant regulatory burden on the qualified accountancy profession in the non-reserved areas (i.e. non-audit work) to which unqualified individuals do not subscribe.

Q3. Do you agree that the sanctions imposed by Tribunals should act as a credible deterrent and be proportionate to the seriousness of the misconduct and to all the circumstances of the case, including the financial resources of members and size and financial resources of Member Firms?

We fully support the desire to develop a sanctions regime which provides for enhanced clarity and consistent decision-making by the Tribunals, which are charged with the hearing of public interest cases. In this respect, we fully support the Board's aim to provide guidance to the Tribunals.

Notwithstanding this, the AADB has referred to a number of authorities on good regulation (the five Hampton principles) and the role of sanctions (the rulings of the Supreme Court in *R (on the application of Coke-Wallis) v The Institute of Chartered Accountants in England and Wales* and also Prof. Macrory's final report on the effectiveness of sanctions). We have found it difficult to reconcile the proposed concept of "responsive sanctioning" (in terms of which

regulators should have sufficient flexibility to apply punitive sanctions) with the views of the Supreme Court, which has expressly stated that in the area of professional discipline the primary purposes of a sanction is not to punish but rather to protect the public interest. The AADB applies only to a small group of individuals and firms and its primary purpose is to protect the public interest (all prospective AADB cases must involve an alleged act of misconduct and meet a "public interest test"). In the field of professional discipline, it is our position that the sanction imposed should be proportionate to the seriousness of the misconduct and to all the circumstances of the case.

Against this background, we do not accept that the sanctions imposed by Tribunals should be calculated in such a way as to convey a deterrent and punitive purpose. Regrettably, the proposed formula for the calculation of a financial penalty based on turnover or earnings would appear to reflect many of the features normally associated with criminal proceedings deriving from a regulatory breach, rather than professional discipline and regulation (i.e. severe financial penalties are intended to be a deterrent and punitive in purpose). We believe it is important to acknowledge that cases before AADB will most often stem from systemic failures in otherwise robust audit procedures within a Member Firm, rather than as a result of wilful recklessness.

While we accept that the proposed adjustment for deterrence is one factor which a Tribunal may elect to make, the guidance appears quite prescriptive on this issue when considered alongside the financial penalty mechanism.

Q4. Have we included the sorts of factors in the sanctions guidance that you would expect to see taken into account by Tribunals?

With reference to the indicative sanctions guidance, we would wish to make the following comments:-

1. Waiver/Repayment of client fees is not a power which ICAS has in relation to its Members or Member Firms and we therefore cannot delegate such powers to the AADB (Page 25, Paragraph 16).
2. The most appropriate factor for the order of a financial penalty ought to be whether it would be a proportionate response to the alleged conduct to impose such a monetary fine, noting that the primary sanction will be an order of a non-financial nature (and therefore have professional and reputational implications for the Member or Member Firm concerned). We are also surprised to note that the sanctions guidance does not include proportionality as a key factor for the Tribunal's consideration when determining the appropriateness of a financial penalty (Page 29, Paragraph 27). Instead, deterrence appears to be a key consideration and proportionality appears only in relation to the quantum of the fine itself (Paragraph 28).
3. The calculation of a financial penalty with regard to a Member or Member Firm's financial resources is of key concern for ICAS, for the reasons outlined above. We accept that a Member or Member Firm's ability to pay must always be a factor for a Tribunal, but an express desire to ensure that a finding is felt in the Member or Member Firm's pocket is punitive and we would suggest is not in keeping with current professional disciplinary practice (Page 29, Paragraph 29).
4. The financial benefit derived from the misconduct and/or the risk of loss of significant sums of money are stated as factors to be taken into account when assessing both the seriousness of the misconduct and the level of a fine (Page 30, Paragraph 31). The allocation of interest on the benefit of such monies is also stated as a factor in assessing both the seriousness of a breach of standards and the quantum of the fine. Not only will

it be difficult, costly and possibly impractical for a Tribunal to assess this benefit/loss but to assess a fine against such criteria appears to be punitive in nature.

5. The proposed calculation of a fine based on a Member Firm's turnover or Member's earnings is, we think, a new development in the field of professional discipline. We accept that a similar policy may be adopted by other regulators and that the FRC would like to achieve an equal footing but we consider that the proposed mechanism appears to be punitive in nature. See our comments in relation to Question 8. We would also observe that it is difficult to comment properly without the percentage details in relation to turnover and earnings.
6. Intent and recklessness are usually perceived as aggravating factors. It may be helpful to include them in Paragraph 48.
7. We would expect a greater level of detail on the procedure for early settlement of cases. ICAS is conscious of the need to avoid any suggestion that public interest cases are being settled 'behind closed doors'.

Q5. Are there any factors you believe Tribunals should take into account when deciding sanction that we have overlooked?

We consider that the key factors have been identified, subject to the comments set out in this response.

Q6. Do you agree that there needs to be an adjustment in the level of fines imposed in AADB cases?

We have no comment on the level of fines imposed in AADB cases and we are unaware of any pressures for AADB to significantly increase fine levels. Notwithstanding our comments elsewhere in this response we would observe that, in our experience, it may prove difficult to dictate the quantum of fines to a tribunal.

Q7. If so, what adjustment do you consider to be appropriate?

Q8. What is your view of the alternative mechanisms proposed for calculating fines?

ICAS is deeply concerned about the proposed use of turnover as the basis for determining disciplinary fines. Whilst, in practice, ICAS Member Firms may not be as exposed to the full weight of this policy as the Member Firms of other Participant Bodies, we can nevertheless observe the many difficulties that such a policy will present. We firmly believe that the mechanism is close to being punitive in nature and will be difficult to implement. We also remain deeply concerned that the Participant Bodies will be expected to adopt a similar policy in the future.

Q9. What level of turnover/income do you consider would be appropriate in respect of each mechanism?

It is difficult to respond to this question as it assumes there are no objections to the mechanism itself. Naturally, there will be cases where a Tribunal may wish to have regard to a firm's turnover in the most serious of cases but the proposed mechanism sets this as the basis for all financial penalties. This mechanism is unlikely to deliver consistent financial penalties which are proportionate to the finding of misconduct.

Q10. Do you agree that Tribunals should not take account of the costs that it is considering awarding against a Member or Member Firm when determining the appropriate level for a Fine?

The total financial award against a Member or Member Firm should be considered by each Tribunal where there issues over ability to pay. This principle should apply to both AADB and any Tribunal appointed by each of the Participant Bodies. Otherwise, we consider the quantum of a fine should be a proportionate response to the finding of misconduct.

Q.11 Do you have any other comments about the proposed structure or content of the sanctions guidance?

We have set out our comments within the body of this response.