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BY EMAIL: AEPconsultation@frc.org.uk

Date	Our reference	Your reference
7 October 2021	UAVH/UJJR/USWB	AEP Consultation

Dear General Counsel Team

Response to consultation on proposed amendments to the Audit Enforcement Procedure ("AEP")

1. Introduction

1.1 We welcome the opportunity to respond to the consultation on the Financial Reporting Council's ("**FRC**") proposed amendments to the AEP.

1.2 Taylor Wessing LLP has considerable experience of acting for the accountancy profession (both for firms and individuals) in relation to regulatory investigations. Our team's experience includes acting on some of the most significant investigations by the FRC and its predecessors, including *Barings*, *Mayflower*, *Cattles*, *Connaught*, *Tanfield*, *Quindell*, *Manchester Building Society*, *BHS*, *Autonomy*, *and Patisserie Holdings plc*. We have also acted for most of the larger firms across numerous actions alleging audit negligence.

1.3 In the last five years alone, we have been involved in some 30 regulatory investigations for the largest audit firms, audit partners, and executives. Since the AEP was introduced in June 2016, we have advised on about 18 AEP investigations. We have also assisted firms in responding to Case Examination enquiries and dealing with Constructive Engagement processes.

1.4 As a result, we have considerable experience of how the existing AEP operates in practice, and we have regular interactions with the Executive Counsel and her team in the Enforcement Division concerning the matters on which we are instructed as well as the enforcement process more generally.

1.5 Against that background, we set out our comments on the proposed amendments to the AEP below by reference to the three questions posed in the consultation document.

1.6 Defined terms in this letter have the meaning given to them in the amended AEP unless stated otherwise.

2. Question 1: Do you have any comments on the changes to the AEP set out above? Please respond by reference to specific Rule numbers of the amended AEP.

Part 1 – Interpretation/Glossary

2.1 We do not have any comments on the changes to the Interpretation/Glossary save as addressed below in relation to the other sections of the AEP.

Part 2 – Initial Stages

Rules 3 to 5: Initial Action by Case Examiner

2.2 In our view it is helpful that the amended AEP now includes (at Rule 3(a)) an express power for the Case Examiner to give notice in writing to require any Statutory Auditor or Statutory Audit Firm to provide information; this will remove the existing uncertainty as to the status of document requests by the Case Examiner and the client confidentiality issues to which they gave rise.

2.3 The power given to the Case Examiner by Rule 3(a) extends to requiring the Statutory Auditor or Statutory Audit Firm *"to create documents"* which relate to the Statutory Audit. It is unclear what this power is intended to cover, and we consider that it would be helpful if guidance were provided as to the types of documents which a Case Examiner might require to be created. Ideally, the categories of documents would be set out within Rule 3 but, if that would be unwieldly, it could be addressed in separate guidance.

2.4 In general, we welcome the new, broad powers proposed for the Case Examiner, but we would hope that the fact such powers are available would not result in the Case Examination and Constructive Engagement process moving from being what is generally regarded as an efficient, streamlined process to a more cumbersome investigation process whereby documents are sought from a variety of sources, and the timeline is drawn out due to the need to review more extensive information. We consider that guidance should be given in relation to the use by the Case Examiner of the powers and the extent to which they differ from the investigation stage.

2.5 It unclear from the amended AEP the information that the Case Examiner will provide when they refer *"the matter"* to the Board. That is a consequence of the deletion of *"Allegation"* from this part of the AEP. It seems to us important that the Case Examiner sets out the Relevant Requirement(s) which they consider may have been breached and it would be helpful if the amended AEP were expressly to set this out requirement. The same point applies to Rule 9 where, *"the matter*" having been referred to the Board, the Board considers that there is a good reason to investigate and refers *"the matter"* to the Executive Counsel.

Rules 6 to 10: Decision to Investigate

2.6 Rule 6 provides that where a matter is referred to the Board by the Case Examiner under Rule 5(d), the Board shall consider whether to direct the Case Examiner to attempt to resolve the matter through Constructive Engagement with the Statutory Auditor or

Statutory Audit Firm. Depending on the outcome of that process, the Board may then consider whether there is good reason to investigate the matter.

2.7 Rules 6 to 10 do not make any provision for the Respondents to be made aware of the information provided to the Board when a decision is made by the Case Examiner to refer a matter, or to make submissions as to whether the Case Examiner should be directed to attempt to resolve the matter through Constructive Engagement.

2.8 We consider that the amended AEP should include provision for:

(a) the Respondents to be informed which specific Relevant Requirements the Case Examiner considers may have been breached and which they are referring to the Board; and

(b) the Respondents to have an opportunity to make submissions to the Board as to the appropriate next steps (such as referring the matter back to Constructive Engagement).

2.9 We have experience of matters where, following submissions by a Statutory Audit Firm, the Board has decided to refer a matter back to Constructive Engagement notwithstanding that the Case Examiner considered that it should proceed to investigation. The matter was then resolved through Constructive Engagement. This demonstrates that transparency, and the opportunity for Respondents to make submissions, can have a positive and meaningful impact on the process.

Rule 11: Notice of Investigation

2.10 Rule 11 provides that a Notice of Investigation should *"state"* the scope of the investigation. This is a change from the existing Rule 7 which requires the Notice of Investigation to *"outline"* the scope. It is unclear whether this change is intended to have a substantive impact on the level of detail included in a Notice of Investigation. We do not consider that it would be appropriate for such notices to contain less detail than is presently the case.

Part 3 – Investigation

Rules 12 and 13: Amending the Scope of an Investigation

2.11 The power for the Board, on the recommendation of the Executive Counsel, to extend the scope of an investigation is of course a new one. In line with our comments at paragraphs 2.6 to 2.8 above in relation to the referral of a matter to the Board by the Case Examiner, we consider that the Respondents should be informed of the proposed scope extension at the time the matter is referred to the Board by the Executive Counsel and afforded the opportunity to make submissions to the Board before it makes any decision.

Rules 14 and 15: Investigation Powers

2.12 Rule 14(a) gives the Executive Counsel a new power to require a Statutory Auditor or Statutory Audit Firm *"to create documents"*. This is the same power given to the Case Examiner by Rule 3(a). As set out above at paragraph 2.3 in relation to Rule 3(a), we consider that further guidance is needed in relation to the scope of this power.

2.13 We welcome the new power for the Executive Counsel to interview an individual at third parties, including the PIE (Rule 15(b)). We consider it helpful that the Executive Counsel can gather evidence in relation to the accounts preparation process and (as explained at paragraphs 2.16 to 2.18 below) this evidence should also fall within the scope of the Executive Counsel's disclosure obligations.

Rules 16 to 18: Investigation Report

2.14 The amended AEP has removed the obligation on the Executive Counsel to provide to the Respondents an Initial Investigation Report ("**IIR**") and the opportunity to make representations before an Investigation Report is finalised.

2.15 As a matter of practice, it is our experience that Executive Counsel will commonly provide drafts of the proposed findings in advance (whether in the form of a draft IIR or otherwise) for the Respondents to consider. We consider that is a helpful stage in the process. It is generally the first opportunity for the Respondents to see the Executive Counsel's preliminary conclusions and to comment on them. It is an important stage; it enables discussions to take place and submissions to be made which would influence the scope of the final Investigation Report. Such a step should still be maintained in advance of the finalisation of the Investigation Report.

2.16 Rule 16(d) provides that the Executive Counsel shall disclose with the Investigation Report *"the key evidence that Executive Counsel considers relevant"*. Under the current rules, the Executive Counsel is expected to provide *"any relevant accompanying papers"* with the IIR. We consider that there needs to be further clarity as to what amounts to *"key evidence"* and that the Executive Counsel should be under an obligation to provide broader disclosure, including documentation which does not support her case.

2.17 We consider this to be a matter of basic fairness and note such obligations are reflected in s.394 of the Financial Services and Markets Act 2000[1] which applies when the FCA or PRA issue a Warning Notice. On the basis of that regime the Executive Counsel would be obliged to provide with the Investigation Report:

(a) the material relied upon to support the position that Relevant Requirements have been breached by the Respondents; and

(b) any secondary material which might undermine the Executive Counsel's position in relation to the alleged breaches.

2.18 Such *"secondary material"* should include (a) any material which was considered by Executive Counsel in reaching her view on the alleged breaches and (b) any material obtained by the Executive Counsel which potentially relates to the breaches but was not considered by the Executive Counsel in framing the allegations.

Rules 23 to 28: Final Decision Notice – the Independent Reviewer

2.19 Rules 23 to 28 address the introduction of a new stage whereby, if the Respondents agree to a Proposed Decision Notice to the satisfaction of Executive Counsel it shall be referred to an Independent Reviewer for approval. We agree, provided that the Independent Reviewer is a competent legally qualified professional.

Rules 29 to 31: Referral to the Tribunal by Executive Counsel

[1] https://www.legislation.gov.uk/ukpga/2000/8/section/394

2.20 The current AEP permits the Enforcement Committee to refer a matter to a Tribunal after giving the Respondents an opportunity to respond to the Decision Notice. Under the amended AEP, the Executive Counsel can refer a matter directly to the Tribunal, even where the Independent Reviewer has declined to approve the Decision Notice or Settlement. That seems to us wrong in principle.

2.21 An independent third party – removed from the investigation – should have oversight in relation to that decision. Otherwise, the parties will need to embark on a time consuming and expensive Tribunal process before another third party (the Tribunal) can consider whether the case was properly brought. A check against the Executive Counsel's decision-making process should be made earlier in the process, with the Respondents being given a chance to make submissions to that third party.

2.22 We suggest that the role of the Enforcement Committee therefore be preserved at this stage or the role should be allocated to the Board. Maintaining the role of the Enforcement Committee as a check before a matter can be referred to Tribunal would allow it to play a similar role to the FCA's Regulatory Decisions Committee which decides whether to issue a Decision Notice, having heard submissions from the parties in relation to the Enforcement Team's Warning Notice, following which the matter can be referred to the Upper Tribunal if required. In the alternative, an appropriately constituted panel of independent reviewers (that is, including appropriate audit expertise, and not only legal expertise) could perform that role.

Part 4 – The Tribunal

2.23 Rule 34 provides that within 56 days of receipt of notification of the appointment of the Tribunal, or such other period of time as may be agreed between the Parties, the Executive Counsel shall serve on the Respondents and the Tribunal an Allegation, together with any *"factual evidence"* on which Executive Counsel relies. In the same vein as set out at paragraphs 2.16 to 2.18, which address the Investigation Report, we consider that the disclosure obligation on the Executive Counsel should be wider at this stage.

2.24 Rule 35 provides that the Chair or the Tribunal may, upon application of a Party, amend the Allegation provided that the amendment can be made *"without injustice"*. This seems to us a very broad power and that, if the Executive Counsel chooses to amend the Allegation, the Respondents should not bear the costs of the amendment.

2.25 Rule 36 provides that Proposed Decision Notices shall be treated as being made 'without prejudice save as to costs' unless the parties agree otherwise and may not be provided to, or referred to before, the Tribunal until the Tribunal has determined whether the Respondents have breached a Relevant Requirement.

2.26 We agree that a draft Proposed Decision Notice issued as part of without prejudice discussions between the Executive Counsel and Respondents should remain privileged. However, if a matter is not settled and Executive Counsel serves a Proposed Decision Notice under Rule 21 as a precursor to referral to the Tribunal under Rule 26, that document should not remain subject to without prejudice privilege. If a case is not resolved between the Executive Counsel and Respondents, it is important in our view, as a matter of natural justice, that the Executive Counsel sets out her present position on the matter (as encapsulated in the Proposed Decision Notice) on an open basis before it proceeds to Enforcement Committee and/or Tribunal.

2.27 Rule 52 provides that *"a finding or court-approved statement of fact"* in certain civil or criminal proceedings shall be *"prima facie evidence of the facts found"*. While we agree that criminal convictions should be treated as prima facie evidence of the wrongdoing, we do not consider that findings in civil proceedings should be treated in the same manner. The focus of such proceedings may not have been on the work of the Respondents and the Respondents will generally have had no opportunity to make submissions/representations in those proceedings. The Tribunal should hear the evidence and make its own findings, without using another court's finding as prima facie evidence of facts found. That is not to say that civil court findings should be ignored but, if admissible, the Tribunal should in our view apportion appropriate weight to such findings as opposed to treating them as prima facie factual evidence.

Part 6 – Settlement

2.28 We welcome the introduction of text within the amended AEP dealing with settlement. We repeat our comments at paragraph 2.19 above in relation to the expertise and utility of the role of the Independent Reviewer in relation to the Proposed Settlement Decision Notice.

Part 7 – Appeal

2.29 We note that the grounds for appeal, under Rule 117, have been extended to include *"based on a material misstatement of fact"* and also *"manifestly unreasonable"* (the latter only previously available in relation to sanction). We consider the extensions to the grounds of appeal to be helpful.

Part 11 – General

Rules 153 to 169: Joint Tribunals

2.30 We consider the introduction of Joint Tribunals for AEP and Accountancy Scheme matters where there are common issues to be a helpful development. A weakness of the current AEP is that complaints in relation to Statutory Audit Firms and members in business of a PIE relating to the same matters are not heard together.

2.31 We note, however, that only the Executive Counsel has the right to request a Joint Tribunal. That power should also be extended to Tribunals, who could make a similar request to the Convenor, and to Respondents. In order to facilitate that process, the Executive Counsel should disclose to the Tribunal and the Respondents other actions which raise common questions of fact, or which arise out of the same events or circumstances.

Rules 168 to 170: Transitional Provisions

2.32 Rule 169 provides that *"Subject to Rule 170, all matters relating to the alleged breach of a Relevant Requirement are to be conducted in accordance with the provisions of the AEP in force at the time of the proceedings"*. It is unclear what "*at the time of the proceedings"* means and it would be helpful if this was clarified.

3. Question 2: Do you agree with the proposed amendments to the AEP? Please respond by reference to specific Rule numbers of the amended AEP.

3.1 We agree with the proposed amendments to the AEP subject to the points flagged in response to Question 1 above.

4. Question 3: Do you have any general comments on the amended AEP?

4.1 Based on our experience, we have the following observations about the operation of the AEP generally, and areas in relation to which the amended AEP (and practice) could be bolstered to further improve the investigation and enforcement process.

Engagement of external audit experts

4.2 We are aware that when a matter is referred for investigation, the Executive Counsel will generally engage an external audit expert to consider the issues under investigation and report to the Executive Counsel's team. In our view, it would be helpful if the external expert were engaged earlier in the process than presently appears to be the case.

4.3 In our experience, the external expert is often engaged by the Executive Counsel only after the Executive Counsel's team have reviewed the audit files and interviewed members of the audit team. This can lead to delay and duplication. It seems to us that if the external expert were engaged at the start of the investigation matters would progress more swiftly, and potential duplication in questions asked of the audit team would be avoided.

4.4 We consider that it would be helpful if the amended AEP made provision for the possibility of a meeting between the expert and the Respondents' experts (internal or external) at the investigation stage, before the Investigation Report is finalised. While such a meeting is unlikely to be necessary or appropriate in every case, in our experience there are instances in which a meeting between the experts would be helpful to try to narrow the scope of an Allegation or issues in dispute; in particular, where the matter turns on interpretation of an accounting or audit standard.

Scope for settlement offers (offering costs protection) by Respondents

4.5 While Part 6 of the amended AEP sets out the process by which the Executive Counsel and Respondents may agree to settle an investigation, it does not include any provision for Respondents to make settlement proposals for sanctions which might provide costs protection.

4.6 We consider that it would be helpful (and would promote the likelihood of early resolution of cases) if the amended AEP included a rule (akin to Part 36 of the Civil Procedure Rules[2]) which enabled Respondents to make a proposal in relation to sanction following which, if the matter went to Tribunal and there were adverse findings against the Respondents but the Executive Counsel failed to obtain a decision on sanctions more advantageous than the Respondents' offer, the Respondents would not be required to pay the Executive Counsel her costs from the point at which the settlement offer was unreasonably refused.

Mediation

4.7 Similarly, we consider that there is scope for Executive Counsel to consider mediation in appropriate cases. It is a mechanism used by other regulators, including the FCA[3], and could be used to facilitate the efficient resolution of investigations.

[2] https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part36
[3] Paragraph EG 5.6 of the FCA Enforcement Guide (https://www.handbook.fca.org.uk/handbook/EG/5/6.html)

An express power for the Executive Counsel to pursue a Statutory Audit Firm only

4.8 In our experience, where the Executive Counsel issues a Notice of Investigation in relation to a Statutory Audit she will generally name both the Statutory Audit Firm and Statutory Auditor as the subjects. This, in turn, means that in those case where the Executive Counsel decides to take Enforcement Action, that action is taken against both the Statutory Audit Firm and Statutory Auditor.

4.9 We consider that it would be helpful if the amended AEP included an express power for the Executive Counsel to decide, in her discretion, to take Enforcement Action against a Statutory Audit Firm only and not a Statutory Auditor. While it may often be the case that it is appropriate for Enforcement Action to be taken against both Respondents, it seems to us that it is unhelpful for that to be the default position; there are instances in which there may be good reasons why a Statutory Auditor should not be pursued simply as a consequence of action being taken against the Statutory Audit Firm. It is undeniable that being named as a Respondent to an AEP investigation blights the careers of individuals. We understand of course that the AEP process no longer need entail an allegation of Misconduct, but that nuance in our experience is not appreciated by the market.

Sanctions

4.10 The FRC's sanctions regime was, of course, the subject of a separate consultation in 2017, led by Sir Christopher Clarke. That was in the very early days of the AEP. We are now some four years on, and there have been thirteen Decision Notices under the AEP.

4.11 In light of Executive Counsel's experience over the last few years, it would be helpful if she were to provide further updated guidance as to how it operates in practice, so as to bring about a greater level of consistency and predictability to proposed sanctions. That would help market participants and firms better to understand the sanctions imposed under the AEP, and further lead to swifter settlements.

5. Conclusion

5.1 We hope that you will find our comments on the amended AEP helpful. We would be happy to discuss any of our comments with you in further detail

If you have any queries or require any further information or clarification in relation to the comments set out above, please do not hesitate to contact, [redacted]

Yours faithfully

[redacted]

Taylor Wessing LLP