RESPONSE FROM MIRA MAKAR MA FCA, witness

Extract from the Introduction to Consultation on Tribunals

1.1

The Financial Reporting Council (FRC) is the UK's independent regulator of the accountancy and actuarial professions in the UK and is responsible for promoting high quality corporate governance and reporting to foster investment. One of its core functions is the operation of two separate yet similar disciplinary Schemes[1], one covering the accountancy profession and the other the actuarial profession.

These Schemes provide for the investigation of situations where there may have been misconduct by a member of one of these two professions and, if appropriate, the pursuit of disciplinary proceedings.

1.2

Following the restructuring of the FRC with effect from 2 July 2012, responsibility for operating the disciplinary Schemes will transfer from the Accountancy and Actuarial Discipline Board (AADB) to the FRC through the Conduct Committee, which will assume day to day responsibility for the oversight and maintenance of the disciplinary arrangements.

1.3

The disciplinary Schemes have been in operation since 2004 and 2007 respectively and, with the benefit of that experience, the FRC is proposing a number of changes to the way in which the disciplinary Schemes operate. The primary objective of these changes is to enhance the efficiency and effectiveness of the disciplinary arrangements. Many of the main changes now proposed were foreshadowed in the joint BIS/FRC consultation on the future role of the FRC.

The witness: Mira Makar MA FCA LRAD ARAD
Relevant Experience: 30 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 witness thanks the FRC for the opportunity to provide evidence to assist the FRC in preparing its requests for empowerment to Parliament and to properly and transparently air challenges. This includes in particular that evidence that was provided by witnesses in the joint BIS/FRC consultation and which the FRC has not yet applied in formulating its requests. The FRC has not yet published a merged list of points that have been raised but which have not been adopted with a reason why not. This must be properly addressed and published in advance of any further submissions from the FRC, in particular in order not to waste Parliamentary time, expenses now reported to be running at £90m per annum, ie premium time that must be properly used by ensuring that evidence from consultations is fully taken into account.

FOSTERING INVESTMENT

2. The "raison d'etre" of the FRC as stated in the preamble and context setting of the questions, is to "foster investment" by what the FRC does. As at 19 September 2012 ONS figures in respect of young Londoners were:
    a. 120,000 people aged 16-24 unemployed in London
    b. 49,455 claiming jobseekers allowance (JSA)
    c. 100% increase in young people claiming JSA for more than six months since general election
    d. £145 million annual cost of JSA to the tax payer
    e. 24,000 unemployed for more than 12 months
    f. 240% rise in long term young unemployed in the UK
    g. £28 billion projected cost of youth unemployment in UK over the next decade.

3. The day before, Ian Powell, PwC, for the first time published that on average PwC members pay £305k tax per annum. This comes in the midst of House of Lords enquiries into market concentration, restrictive practices, polarisation of the "giants" from the "rest", and cancelling audit requirements for all but the largest, purportedly to reduce red tape. Second tier firms now say "*we don't want the big audits, they carry too much risk*" and smaller firms cannot offer training contracts guaranteeing audit experience because the barriers to entry are too great; compliance costs too heavy; and without a base to start there is no means of getting in. Small firms that do limited audit work, cannot guarantee to share it amongst staff and must have a sign off from a licensed person. This standard of rigour is absent in the giants, who are happy to field staff to a bank's audit who have never done a bank reconciliation, audited post opening procedures, or worked in an environment that is not based on "*exceptions reporting*", in which each risk had to be included in the matters for the attention of partners and the disposal of the item logged and retained.
4. The message is clear, the polarisation of "haves" and "have nots" has increased and the largest shift of capital in civilised times to the individuals in investment banks and those who seek to emulate them, is as entrenched in the audit and assurance business as it is in the banks.
5. How the firms have achieved this, and still managed to sign auditor's reports on defaulting banks, that properly ought not to have been signed, requires an examination of the relationship between the auditor and the banks. This is in particular since 1986, when houses were allowed to sell multiple products, by- passing the rigours of single product sales, and permissive of the manufacture of "money" and "risk shift" instruments, that no-one fully understood, and which went contrary to all the principles of growth and prosperity: being financial certainty (predictability of outcome) and confidence in the banking system, together the assurance represented by an audit certificate.

Limited Liability Partnership Act 2000

6. The post millennium slump (collapse in dot coms; telecoms; IT; funds subject to redemption) co-incided with the Limited Liability Partnership Act 2000, the result of lobbying by those wishing to join the mania for trading in money and money based products with no apparent intrinsic worth. This allowed the businesses to incorporate on a tax free basis, taking their defaults and contingent liabilities with them, and litigating away risk when it came home to roost.

7. A market came into being mimicking the greed of the bankers, that parcelled risk, traded risk, and even did deals that transferred risk from an assurance vendor, to those they audited. They could be eliminated either by some off

balance sheet mechanism; by finding a professional negligence insurance policy and converting the risk into a Claim by an insured person by some device or other; or by blaming someone else, and being let off prosecution for knowing or reckless conduct by promoting "Tribunals" and coming out with a trivial fine, and no more.

So long as directors got jailed (as the AIT directors in 2005, essentially for succumbing to bullying by their sponsor, to making pre close statements and not resigning) and the bankers carried the reputational damage (JPMorgan, mixing client monies), the auditor could always find an accommodating lawyer that would be happy to tell a Tribunal, as Tim Dutton, Herbert Smith LLP, did for PwC, this was an "*honest mistake*". In other works, what is reckless behaviour to the rest of the world who are made to serve time, and face a "double whammy", under the evidence rules, losing their licence and fined, is a mechanism by which the same offence can become a rap on the knuckles, that is so trivial as to be not even noticed by those paying on average £300k tax a year.

8. Soon, the greed spread to those wanting to make money from this fresh market, and into existence came "ANONYMISATION" – the latest product from the legal industry, where "commercial" results (branded "outcome based" by the licensing body) could be achieved, without anyone knowing who was benefitting or who paying. Client monies accounts became available for movements of cash, directors became "corporate directors"; trustees replaced by "corporate trustees"; legal privilege became separated from its owner; and court proceedings started by persons who disappeared shortly after the claim form lapsed, as party after party put themselves on the record, and court orders to achieve a "commercial outcome" replaced the conventional, but unfashionable, "approved judgment".

9. By 2005, the battle lines were drawn: foreign investors didn't invest ("*we do not believe the balance sheet"*); the burden of AIM proved too much for NOMADS, with no experience of being plc directors, but effectively seeking to manage risk as though they were, without the information; and the furious pace of diluting the Companies Act out of existence became a frenzy. By 2006, the likes of PwC with Herbert Smith had started re-writing the Act, publishing joint statements that said the obligation from April 2005 on any person to provide information relevant to the duties of the auditor, to him must do so, if they hold the information, was to be interpreted, not with reference to the reportable information, but with reference to who they were: if a director or senior employee they were caught, if anybody else, they were not, ***regardless of what knowledge they held***.

10. This "spin" meant that anyone working inside the auditor, who had knowledge of the auditor's default, had no obligation to report, and, as bad, anyone outside with the information was free to withhold it, leaving directors totally exposed. In particular the complaints of the FRC that they found promotion to member/partner was based on salesmanship and not "being a safe pair of hands", was a fertile base for "hiding" defaults from seniors.

    The approach was supported by systems for purging risk reporting of risk, and an army of internal lawyers, prepared to treat the auditor's duties throughout their period of office as though a contract for annual servicing of a gas boiler, with no obligation between visits, and a "report" once a year, that said that they had nothing to report on the key areas of work, but not that, in fact, they had done any including by staff who knew what they were doing.

11. Worse, the same statements invented differences between "non executives" and "executives" and stated that non executives did not have access to records on a routine basis, an extraordinary and arrogant attempt to re-write the Companies Act. The Act does not distinguish between directors and states that a director shall be entitled to have access to records at all times, commensurate with the legal obligation to maintain proper records sufficient to ascertain the trading position of the enterprise at all times.

12. It was a short and predictable step to rebrand non executives as, effectively, not part of the board and, in a blur of muddled thinking, that they could be "independent", when a director, by definition, can never be independent, essentially of himself, as being the lynch-pin under the Act. Soon audit partners retired into non executive directors, astonishingly, without having ever had experience of being a plc executive director themselves, and therefore, hopelessly unqualified, and a source of unmitigated risk to the Board on which they served. The anticipation of this sinecure meant that the auditor could never be independent in their reporting.

13. It was against this background that the FRC made known (i) it took no action whilst live crimes of false accounting/reporting by the auditor took place; (ii) its inspections excluded LIVE inspections of assurance reporting, rendering it a wholly useless exercise, as "after the event" it was too late; (iii) it relied on external labour, depriving itself of build up of experience, and massively increasing cost; (iv) its staff, although licencees of a body with mandatory reporting obligations, appeared, inexplicably, to consider themselves excluded from the duty to report misconduct; (v) it hired lawyers, who could never properly be involved in disciplinary activities, since they had no licence from ICAEW (or the equivalent), and therefore carried neither credentials nor credibility.

Rapidly odd notions came into being, that the auditor's duty to report was other than to the directors; that the auditor's exclusion of liability to banks, meant they could dump the consequences of their own defaults onto the banks and exit with apparent impunity; that what was "statutory confidentiality" became something else, without the constraints; and secondary markets emerged attempting to target fund managers "as though" the auditor sought to be a poor cousin of the investor relations teams in the brokers and sponsors/NOMADS.

ASSESSMENT OF THE SCHEME

14. There are two separate questions:
    a. What does the Scheme seek to achieve?
    b. If the Scheme does not achieve its objectives, can tinkering make it work?

15. There are a number of points of clarification to start:
    a. The FRC cannot itself compel investment, stop capital fleeing, employ the current youth, who cannot see, from where their prospects are coming;

    b. The FRC can, and must, take all steps within its power, to create circumstances of financial certainty and assimilation of data that Ministers can rely on in making decisions. Certainty that auditors will be "let off" their defaults, whilst company directors are imprisoned, is not the certainty that investors want, as they say "*it is about management, management and management"*, not a defaulting auditor, looking to avoid the consequences of their defaults whilst preserving their reputation and profit stream.

    c. The FRC is not ICAEW or other licensing body, it cannot discipline with reference to the by laws of ICAEW, nor can it prosecute with reference to the Companies Act, Theft Act, POCA; Bribery Act etc.

    d. FRC staff can refer to BIS for prosecution, and have a duty to report to the Head of Staff of ICAEW (or equivalent), including self reporting. They do not (apparently).

    e. Assurance reporting (direct access or otherwise) is black and white, either the result is right or it is wrong, if wrong either knowingly wrong or recklessly wrong. There is no place for "professional negligence" nor for "discretionary" decision making, as to whether to pursue a matter or not.

f. The cost of failing to act is incalculable, as is the cost of perpetuating incorrect notions, as the notion that Tribunals can be an effective sanction, equivalent to serving time that directors face, including in regard to the defaults of their supply chain, including the auditor.

g. There is no current mechanism for Ministers to receive data on the impact of market concentration, and the number of years more and more firms have lost audit experience, and the financial barrier to getting in again. The FRC ought to provide this risk management data.

h. The FRC has not taken any steps to recommend parity between the auditor and those audited, including the equivalent disclosure to a prospectus on conversion to LLP, disclosure of members' agreements; insurance contracts; pay of those working on any audit and in published accounts.

i. The FRC has not taken steps to show that the financial failure of a giant will have no real impact, so long as others can pick up: the quickest way to achieve that de-risking is the insistence on published price lists with experience of the individuals, giving the buyers the option of saying "thanks but no thanks" to those seeking to charge for learning, and excluding the smaller players who might have niche expertise. Mixed team working is common in many industries and there is no prima facie reason why it cannot work here.

16. **It is from the point of view of achieving financial certainty, including certainty of sanctions in the event of default, that the FRC's aspiration of promoting investment can be realised. Whether that is best achieved by being rolled back into BIS or not, is secondary. The questions below are addressed with this in mind.**

Mira Makar MA FCA

5 Questions

The FRC would welcome views on the following questions:

1. *Should the Schemes be amended as set out in paragraphs 3.3 to 3.11 above so as to enhance the independence of the disciplinary arrangements?*

No. The required criteria are that the FRC publishes the criteria that it is enforcing against and to whom it makes referrals for what type of default. It must name its staff and their credentials and be prepared to report transparently on its dependence on sub contracted labour. The FRC has not provided a list of all the investigations that it was involved with during the time of Cameron Scott, who was universally respected, and given public assurance that each one will be completed and not buried with his departure.

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2. Are the proposals to conclude cases without the need for a tribunal hearing appropriate (paragraphs 3.12 to 3.13 above)?

No. Either there is referral to ICAEW/BIS/FSA/SFO, (and no Tribunal) or Tribunal in accordance with published criteria that are not an alternative to prosecution and/or referral to ICAEW(or equivalent). Either way decision makers must have the correct personal experience and exclude lawyers who are not ICAEW (or equivalent) licensed and must be experienced in assurance and regulatory reporting.

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3. *Do you agree with the role envisaged for the Case Management Committee (paragraph 3.15)?*

No. This is a serious exercise and is not about playing musical chairs or creating committees. The FRC was very frank in admitting the shortcomings of its silo structure, but structure and altering it, does not affect the substance of its work. Committees are not the same as saying WHO is doing WHAT; WHY the FRC believes they are COMPETENT, and WHY they are doing it, against WHICH public criteria, and WHAT public reporting.

The FRC ought to prepare a bi-annual cost/benefit and risk assessment of remaining independent compared with being rolled back into BIS, with all staff civil servants, and not reliant on external labour. The cost of external labour ought to be part of the notional bill for staff: if work cannot be done without external labour/expertise, the extra cost is the de facto labour rate. There is no point in the FRC receiving budget that it goes and spends on subcontractors: this is as objectionable as DWP giving personal data to the Post Office to process or the Corporation of London thinking it can meet its statutory obligations to provide a Citizens Advice Bureau by letting out contracts. It can't be done.

4. Are the proposals to facilitate the timely completion of investigations and disciplinary proceedings appropriate (paragraphs 3.16 to 3.18 above)?

This all depends on getting it right. It is impossible to legislate for all eventualities.

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5. *Should the Executive Counsel be able to seek an interim order against a member or member firm? If so, are the proposed provisions (paragraph3.19) appropriate?*

The FRC is in severe danger of engineering a solution to a problem that has no market beyond creating a secondary and inefficient market to the courts. If the FRC will not carry out live inspections (no good reason given) and be prepared to demand IMMEDIATE on the spot repair, it will never, by an "after the event" Tribunal, that replaces penal sanctions, get the same result.

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6. *Do you have any comments on the proposals to amend the investigation Test (paragraphs 3.24 – 3.29)?*

This has been drafted in the abstract. The FRC must assimilate CASE EVIDENCE and then show publicly what it is going to do STEP BY STEP. It has made no call for case evidence, nor has it explained what it is proposing to do with the cases Cameron Scott had in his portfolio before leaving.

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7. *Do you have any other comments on the proposed Schemes or the points raised in this paper?*

FRC needs to clarify before reverting to Parliament what its benchmark criteria are; how this links to promoting investment and therefore employment, how existing problems are to be addressed and what it is going to do to persuade executive directors that its raison d'etre is to help give them FINANCIAL CERTAINTY that they can rely on their auditor, and that the auditor's report is an assurance certificate and not a statement that "*banks are big boys, they can look after themselves"* so who cares if the risk is dumped on them, so long as the auditor can exit with apparent impunity and the assistance of those litigating away the auditor's risk.

The FRC needs to show that it has paid attention to previous consultations and not perpetrate the impression it is going through motions and will forge ahead regardless. It needs to ensure that it has fully consulted and assimilated the evidence of Whistleblowers UK, representing coal face experience of the cost to the economy of the failure to enforce and the impact on economic and social certainty, public confidence and therefore the appetite to invest and to create jobs. The FT last week end introduced the group and the wealth of experience represented.

It must look at every single case a public accountant has entered the courts, as Claimant or Defendant, and carried out an investigation, asking "*why are they there?"* The view that this will prejudice independence is ill-conceived and misplaced.

If the FRC does not align itself with the reality of the current economic wasteland, and current financial instruments of crime that proliferate, it will shortly be perceived as an irrelevant dinosaur of the era of failed self regulation, with public accountants continuing in the last stages of trying to hang onto the principle of "scapegoats" and other techniques of self interest and self preservation at the expense of economic resurgence.