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Dear General Counsel Team

Response to consultation on proposed amendments to the Audit Enforcement Procedure

We welcome the opportunity to respond to the FRC's consultation on proposed reforms to the Audit Enforcement Procedure ("AEP").

1 Introduction

1.1 As a general observation, we broadly welcome the proposed amendments to the AEP, particularly to the extent that the amendments are intended to streamline the process, to reflect practices that have developed since the AEP came into force in 2016, and to provide further detail and clarity in areas where the AEP is currently silent. That said, we do consider that there are certain areas in which the proposed amendments could go further, some areas where further clarity as to the proposed amendments is required, and we do also have some concerns about certain proposed amendments.

1.2 Our comments below focus on those proposed amendments in respect of which we have specific comments. To the extent that we have not commented on any of the proposed amendments, we broadly agree with the proposed amendment, although we note that in some areas further detailed guidance is likely to be required. We also note that ultimately much of the success and effectiveness of the proposed amendments will depend on how the amended rules are applied in practice.

1.3 We have grouped our comments by reference to the stage of the AEP to which

they relate and have used the headings from the AEP.

2 Part 2 – Initial Stages – Rules 3 to 11

Initial Action by Case Examiner and Decision to Investigate - Rules 3 to 10

2.1 We welcome the introduction of the new powers for the Case Examiner in Rule 3. It seems to us that these changes ought to further streamline the Case Examination process and ensure that the Case Examiner has access to all documents and information required in order fully to assess each matter.

2.2 We note that rule 3(a) refers to the ability to require the Statutory Auditor or Statutory Audit Firm "*to create documents*". This wording has also been introduced to Rule 14(a) which deals with the ability of Executive Counsel to require documents and information to be provided once an investigation has commenced. It is not clear what is intended to be covered by this wording. Firms will often create new documents for the FRC in the course of an investigation (for example, supporting materials prepared for the presentations that are often requested by the FRC in the early stages of an investigation), on the basis that this is part of the requirement to provide information. It would be helpful if clarification or explanation could be provided as to the purpose of this amendment and whether it is intended simply to reflect what already happens in practice. If the amendment is intended to go beyond reflecting current practice, we suggest that this is an area in which it would be helpful to produce and publish guidance as to the types of documents that are envisaged.

2.3 We also consider that there is one aspect in respect of which it would be helpful to further amend the rules relating to the Case Examination process, and specifically the referral of matters to the Board for consideration as to whether to commence an investigation. At present, and this will remain the case under the proposed amendments, when the Case Examiner concludes that the information about a Statutory Auditor or Statutory Audit Firm raises a question as to whether there has been a breach of a Relevant Requirement, the Case Examiner may take no action, arrange Constructive Engagement, refer to Executive Counsel to apply for an Interim Order or refer the matter to the Board, for a decision as to whether to commence an investigation.

2.4 In circumstances where the Case Examiner is considering referring the matter to the Board for a decision as to whether to commence an investigation, typically the first that the respondent audit firm knows of this is when they receive notice of the commencement of an investigation. There will often have been very little, if any, indication as to why the case has been referred to investigation, or which Relevant Requirements the Case Examiner considers

may have been breached. It seems to us that this approach potentially risks some matters moving into investigation which could more appropriately and efficiently be dealt with through Constructive Engagement.

2.5 Our experience of Constructive Engagement has been largely positive. The process allows for flexibility, and it enables matters to be dealt with proportionately, efficiently and effectively, and ensures that changes or improvements are put in place promptly by the audit firm to prevent recurrence of the issue, thereby improving audit quality. We acknowledge that there will always be some matters that it is not appropriate or possible to deal with through Constructive Engagement, however we propose that respondents should be given an opportunity to make submissions as to why a matter should be dealt with through Constructive Engagement, or at least an attempt made to resolve through Constructive Engagement, before a matter enters the investigation stage. This would ensure that those involved in the decision making process are aware of all relevant considerations, and reduce the risk of missed opportunities to resolve matters at an early stage.

2.6 This could be given effect by introducing a requirement for the Case Examiner to inform the Statutory Auditor/Audit Firm when they are considering referring the matter to the Board for investigation, and the basis for that decision (including the Relevant Requirements which the Case Examiner considers may have been breached), and to provide the auditor/audit firm with an opportunity to make submissions to the Board as to why the matter should more appropriately be dealt with through Constructive Engagement (or, at the least, an attempt to resolve through Constructive Engagement).

2.7 We note that there may be concerns that this could delay the progress of a matter, however in circumstances where the alternative is that the matter will go straight into an investigation, which may then take several years to conclude, we do not think that adding a short period of time to allow for such submissions to be prepared is likely to have a significant impact on the time taken to resolve the matter. If anything, if the Board is persuaded by the submissions and directs that Constructive Engagement should be arranged, this may well result in a much swifter resolution of the matter than would otherwise have been the case

if it had gone straight into an investigation.

Notice of Investigation – Rule 11

2.8 We note that there has been a small change to the wording of Rule 11, from referring to the Notice of Investigation "outlining" the scope of the investigation to "stating" the scope, although we assume that this change is inconsequential.

2.9 We would encourage a greater exchange of information and clarity as to the basis upon which a matter has been referred to investigation at this early stage. In particular, we suggest that consideration is given as to whether the Notice of Investigation might include details of the Relevant Requirements which at this stage it is considered may have been breached. The Case Examiner will presumably have had to form a view on this when referring the matter to the Board for a decision as whether to commence an investigation, and it would be helpful, and may even facilitate earlier resolution of matters, if that information could be provided to the respondent auditor at the commencement of an investigation.

3 Part 3 – Investigation – Rules 12 to 31

Removal of the requirement for an Initial Investigation Report - Rules 16 to 18

3.1 We understand the reasons why it is proposed that the requirement for an Initial Investigation Report (IIR) is abolished and are generally supportive of amendments which will streamline the process under the AEP. On balance we are comfortable with the removal of the requirement for the IIR, not least because in our experience matters often move straight into settlement discussions and negotiation of terms of a Decision Notice following the response to an IIR, and so there is often in practice only one iteration of the investigation report. That said, as with most of the proposed amendments, much of their success will depend on how they are applied in practice. We would be concerned if the abolition of the IIR in any way had an impact on the consideration given to a respondent auditor's response to the Investigation Report. It also seems to us that there may be some cases in which it will be helpful for all parties to have a further iteration of the Investigation Report, to reflect submissions made by the respondent auditor, and would recommend that the FRC retain some flexibility, and remain open to this approach in specific

cases, even if no longer strictly required.

Changes to the obligation to disclose documents with the Investigation Report – Rule 16(d)

3.2 We note that it is proposed that the requirement to provide documents with the Investigation Report be changed from a requirement to provide "*any relevant accompanying papers*" to a requirement to provide "*the key evidence that Executive Counsel considers relevant*".

3.3 On the face of it, it seems to us that this proposed change might narrow the scope of documents required to be provided with the Investigation Report. It is not clear whether this is the intention of the proposed amendment however. In our experience, we have not to date had many issues or concerns with the disclosure provided by Executive Counsel with IIRs, and a largely pragmatic approach is adopted. We would however be concerned by any proposed narrowing of the disclosure obligation at the time of service of the Investigation Report. At the least, this proposed amendment introduces uncertainty as to what the disclosure obligation is at this stage, whether there is intended to be a change, and further clarification is required.

3.4 We understand that additional guidance on the disclosure obligation may be published in due course, and we would welcome further detail and certainty in this regard. In addition to clarifying what exactly the disclosure obligation is at this stage, it would be helpful if there were a requirement to provide a list of the documents and information which the FRC has obtained during the course of the investigation. The very nature of an FRC investigation means that the respondent auditor will often not have any visibility as to the extent of the documentation or information which the FRC has obtained from others, including the audited entity, during the course of an investigation. In those circumstances, it is not only important that there is clarity on what is and is not required to be disclosed, but also greater visibility as to the pool of documents from which those disclosed documents have been taken.

Replacement of the Enforcement Committee with an Independent Reviewer – Rules 23 to 31

3.5 We note the reasons given for the proposed abolition of the Enforcement Committee and replacement with an Independent Reviewer, and acknowledge that no case has yet proceeded to the Enforcement Committee stage. We do have some concerns as to the scope of the Independent Reviewer's role however, as it seems to us that the Independent Reviewer will not be performing the same role as the Enforcement Committee, potentially leaving a gap in the

level of independent oversight. Under the existing rules, the role of the Enforcement Committee is to deal with matters where it has not been possible to reach agreement as to the terms of a Decision Notice. In those situations, the Statutory Auditor/Audit Firm would be provided with a copy of the information provided to the Enforcement Committee by Executive Counsel and be given an opportunity to make submissions to the Committee.

3.6 The Independent Reviewer will only be required to review and approve Proposed Decision Notices and Settlement Decision Notices when agreement has been reached between Executive Counsel and the Statutory Auditor/Audit Firm. The Consultation notes that this will provide a degree of independent oversight following the conclusion of an investigation and we are content with the proposal to have agreed Proposed Decision Notices and Settlement Decision Notices reviewed by someone independent of the investigation. We note that there is a similar process for approval of settlements under the Accountancy Scheme.

3.7 Under the proposed amended AEP, there is however no role for the Independent Reviewer in circumstances where Executive Counsel and the Statutory Auditor/Audit Firm have not been able to reach agreement and, linked to this, no role for the Independent Reviewer in providing independent oversight of Executive Counsel's decision to refer a case to the Tribunal (Rules 30 and 31).

3.8 This is the very role that the Enforcement Committee was intended to fulfil; to consider matters where it has not been possible to reach agreement as to the terms of a Decision Notice, and then subsequently to make the decision as to whether a matter should be referred to the Tribunal. While that scenario may be unlikely to arise (as demonstrated by the fact that no cases have yet reached the Enforcement Committee stage), we do not necessarily agree that this justifies removing any provision for review by someone independent of the investigation in these circumstances, and we are concerned by the removal of any independent oversight or check and balance at this stage. It seems to us equally important that there should be some independent oversight at the conclusion of an investigation, when it has not been possible to reach agreement, as there is a need for such oversight when a matter is being concluded by agreement.

3.9 The process from the point of referral to the Tribunal, to a final Tribunal hearing can be lengthy and costly for all parties and we consider that it is important, and sensible, that there should remain scope for someone independent of the investigation to consider those matters where agreement has not been possible. If not, the first time that anyone independent of the investigation is likely to

scrutinise Executive Counsel's case could be as late as the final Tribunal hearing, when significant costs will already have been incurred.

3.10 We therefore suggest that further consideration is given to providing for the Independent Reviewer to have a role similar to that intended for the Enforcement Committee, in circumstances where it has not been possible for Executive Counsel and the Statutory Auditor/Audit Firm to come to an agreement, including review of any decision to refer a matter to the Tribunal.

3.11 We note that the Independent Reviewer is proposed to be a lawyer drawn from those on the panel of Tribunal members, and we recognise and agree with the importance of having some legal input to the role of the Independent Reviewer. The role will also however likely involve considering and understanding technical auditing and accounting concepts. We suggest that instead of the role being fulfilled by an individual, there should perhaps be a panel of at least two people – one a lawyer, and the other an experienced auditor.

4 Part 4 – Tribunal – Rules 32 to 78

Findings from other proceedings to be treated as prima facie evidence of the facts found – Rule 52

4.1 We note that the new rule 52 provides that a Tribunal shall treat a finding or court approved statement of fact made by other bodies or officers as prima facie evidence of that fact in the Tribunal's proceedings. While we understand the desire to streamline proceedings, that should not take precedence over fairness or due process.

4.2 It is quite likely that the respondent auditor will not have been involved in, or had any input into or control over those other proceedings from which the finding of fact is taken. It may be the case that the respondent auditor is aware of information or has documents in its possession which, had they been before the body in those other proceedings, might have led to a different finding of fact. If it is intended that the respondent auditor will, as in other regulatory processes, be entitled to challenge that finding of fact, including calling evidence to challenge it, we do not object to this proposed change, but we do consider that it would be helpful to make this clear in the rules.

5 Part 6 – Settlement – Rules 102 to 111

5.1 We note the introduction of the new section in relation to settlement. All AEP cases concluded to date have been resolved through settlement, and it seems to us that this new section largely reflects the practice that has developed over

the years. We agree that it is useful for the AEP to contain a framework for the settlement process, and rules relating to it, however it will be important to maintain a degree of flexibility in how settlement discussions are dealt with on a case by case basis, including, for example, considering the possibility of meetings between experts, and potentially mediations.

Yours faithfully

KPMG LLP