Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

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29 June 2017

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BY EMAIL AND POST

Dear Sirs

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

Deloitte LLP is pleased to respond to the FRC appointed panel (the "***Review Panel***"), tasked with conducting an independent review of the sanctions imposed under the FRC's enforcement procedures.

We have approached this submission by providing an explanation of our key points in this letter and in the Appendix we provide answers to the questions posed by the Review Panel.

Summary

1. The FRC's objective is to promote high quality corporate governance and reporting to foster investment. We believe that the design of sanctions should reflect this and that the Review Panel should therefore focus on the public interest by considering what drives audit quality. Taken in the round, the sanctions regime support the audit profession in carrying out high quality work.

2. In our view quality in the audit profession is already high. The FRC acknowledges in its own reports that member firms have made huge investments in quality in recent years.[1] This investment has not been made as a result of higher sanctions, but rather to address our public interest responsibilities, to meet greater expectations by our clients and wider stakeholders, to protect our brand, reputation and liability, and to attract and retain the best people.

3. We strongly support the need for a mechanism that imposes significant sanctions in cases that involve a lack of integrity, recklessness and dishonesty. However, whilst we recognise the importance of addressing poor quality, significant sanctions will not deter errors of judgement made by individuals going about their work honestly and diligently, or prevent situations where an auditor is deliberately misled or deceived.

4. We believe that financial penalties are already very high and increasing them further is likely to have unintended consequences, making a partner role less appealing to current and future generations of auditors, weakening the attractiveness of the profession and potentially reducing competition in the audit market. In summary:

[1] https://www.frc.org.uk/Our-Work/Audit-and-Actuarial-Regulation/Report-on-Developments-in-Audit.aspx

Deloitte.

a. FRC investigations already have a serious impact on the careers of partners, even if they are subsequently cleared of wrongdoing. Historically investigations have taken many years to resolve and many corporations will not permit a partner to be involved in their audit if they are under investigation. If an adverse finding is made the audit partner concerned may effectively be blocked from auditing, even if the sanction is limited, because of a zero-tolerance approach taken by some corporations and audit committees.

b. High sanctions will also encourage firms and partners to avoid riskier clients that have indications of poor accounting and financial reporting procedures or lax corporate governance standards, since historically adverse FRC findings against auditors have often followed a degree of impropriety at the audited entity. This may exacerbate risk in the market rather than addressing it.

c. The current level of fines already has a material impact on audit practice profitability. If pushed too hard, firms could abandon segments of the audit market altogether, thereby reducing competition in the market.

5. Civil liability already acts as a very powerful deterrent against poor auditing. Whilst in principle auditors are able to secure limitations on their liability, in the PIE audit market on which the FRC is focussed, liability limitation agreements are practically unobtainable, and this exposure cannot be meaningfully insured against.

6. Furthermore, internal and external reviews such as those by the FRC's Audit Quality Review team ("***AQR***"), can have a severe impact on practitioners and firms, and provide effective deterrence to poor quality work.

7. We believe sanctions should be better targeted, more proportionate, enforce remedial action and, where applicable, be aligned with sanctions for company directors.

8. Although outside the scope of the AEP, we would welcome an expansion of the FRC powers to cover directors and members of audit committees who are not members of the relevant accountancy bodies, so that those responsible for inaccurate or fraudulent reporting are held to account.

If you have any questions about our response, please call David Barnes on 020 7303 2888.

Yours faithfully

David Barnes

David Barnes

Deloitte.

APPENDIX

We set out our responses to the questions raised by the independent Review Panel below.

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

The objectives set out in paragraph 9 of the Sanctions Guidance for the Accountancy Scheme (which are the same in the Actuarial Scheme Sanctions Guidance) are set out in Appendix 2. The objectives of the Audit Enforcement Procedure specifically in relation to sanctions are encapsulated in paragraphs 11 and 12 of the Sanctions Policy (Audit Enforcement Procedure) which are, also, set out in Appendix 2.

Response - Question 1

We agree with the objectives as set out in Appendix 2 of the review document. However, we note that 'deterrence' is just one of the objectives and in our view should not carry more weight than the others. Any guidance should make clear that sanctions are not penal in nature, and they should not be applied to individuals or firms disproportionately. We believe that audit quality is of paramount importance, because it is critical for generating trust and confidence in capital markets. Therefore in our view, the review of sanctions needs to focus on what drives audit quality. We do not believe that large financial penalties are the answer other than in cases involving a lack of integrity, recklessness or dishonesty.

Question 2

Is the Sanctions Guidance/Sanctions Policy[2] satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:

(a) guidance, either of the current or some other type;

(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or

(c) some form of guideline which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.

Response - Question 2

We believe that sanctions guidance is essential. The current guidance provides a wealth of information around the factors to consider when determining a sanction, but in our experience there is rarely any meaningful relationship between the breach of a relevant audit requirement that gives rise to an adverse finding, and the metrics that are most frequently referenced as the basis for a tariff, such as a firm's revenue or profit from audit services and profit per partner.

Providing high level guidance, such as indicative ranges for the size of financial penalties, would help further by reducing uncertainties and inconsistencies across cases. It will be challenging, though, to develop a detailed tariff that could be administered fairly and consistently, given the broad range of issues and

[2] Despite its different title, the Sanctions Policy does provide guidance to decision-makers

judgements that would need to be considered. A rigid tariff may also affect an independent tribunal's ability to be flexible in its judgements.

We explore other sanction options in response to questions 11 and 13 which we believe would improve effectiveness of the sanctions policy.

Question 3

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

Response - Question 3

Please see our response to question 2.

Question 4

In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

Response - Question 4

In order to fulfill the aims and objectives of sanctions as stated within the FRC disciplinary schemes, we believe that the FRC should focus on all parties who are at fault. If the focus is solely on the auditors and audit firms this may not address the root cause of the corporate reporting issue, for example a management fraud. Not addressing individuals in business who are at fault undermines confidence in corporate reporting.

As the AEP only applies to auditors, not preparers of accounts, care must be taken when sanctioning auditors to ensure that there is not a perception that the FRC will come down very tough on auditors but will not hold those responsible for corporate reporting accountable. We would welcome an expansion of the FRC's powers in relation to directors and audit committee members who are not members of the relevant accountancy bodies to ensure that those responsible for corporate reporting are held to account, whether they are members of the accountancy bodies or not.

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

If respondents think that the FRC should establish some starting point, they are invited to articulate;

(a) how they consider that starting point should be measured for entities or individuals (e.g. by reference to specified monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);

(b) how the starting point should be determined; and

(c) what criterion/a should produce what starting point(s).

Response - Question 5

Please see our response to question 2. We do not think that a tariff would be appropriate and this includes a starting point for the level of financial penalties.

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

Response - Question 6

Audit quality is high

Based on the FRC's own assessments of member firms' quality, audit quality is high and has improved in recent years. The FRC categorised 81% of FTSE 350 audits reviewed in 2016/17 as requiring 'no more than limited improvements', compared to 77% in 2015/16 and 70% in 2014/15. The FRC's objective, which we support, is for at least 90% of FTSE 350 audits to fall into that category by 2019. Furthermore, the number of FRC investigations that have resulted in a finding has been very low compared to the thousands of audits undertaken each year. People do not set out with the intention to do poor work, and in our view it is clear that poor audit quality is not a systemic issue.

Audit quality has improved because firms have made major, sustained and ongoing investments in audit quality, and have been engaged and committed in responding to the AQR's findings over many years. The motivations behind investments in audit quality include addressing the expectations of clients and stakeholders, protecting our brand and reputation, reducing the risk of civil liability suits, and in order to attract and retain the best people.

The average level of sanctions imposed on accounting firms following a finding of misconduct has increased significantly in the last two years. Until relatively recently, the highest financial sanction for a member firm had been a fine of £2m in 2011 (reduced to £1.4m with a settlement discount). In the last two years, fines for member firms have exceeded £2m on five occasions with the highest fine recorded for a member firm now at £5 million. Together with costs (with the firm paying the FRC's costs of the successful charges), the financial impact on the member firm can be very significant.

The high sanctions that have made the headlines in the last two years have all been for work that was carried out many years ago (in some cases 10 years before the sanction was incurred). If financial sanctions were a key deterrent, we would only be expecting to see an overall increase in audit quality now (as there is always a certain time delay) - the cause and effect that might have been expected if heavy financial sanctions were an effective deterrent is not in evidence.

Drivers of audit quality

The key driver of audit quality at Deloitte is our culture, the calibre, objectivity and character of our people and the steps we take to embed quality in our firmwide and audit systems and processes.

In addition, our quality processes have deterrent elements built into them. Individuals treat these very seriously because they can have a severe impact on their standing in the firm and their compensation.

We acknowledge that the possibility of any regulatory action and sanction, whether that be a fine or a reprimand/severe reprimand acts as one of the deterrents to poor quality work, as any finding against a member firm impacts on their reputation which is essential to their business. The regulatory framework in which we operate is one of the drivers in encouraging member firms to create appropriate quality control processes. However, we do not believe that the threat of financial sanction is something that individual members would consider on a day to day basis when completing their work as they are already trying to fulfill their responsibilities to the best of their ability.

In summary, we agree that the existing sanction regime provides some deterrent effect but we disagree with any suggestion that increasing the size of FRC financial sanctions will create more of a deterrent and we believe that there are other sanction possibilities which would achieve the FRC's objectives more effectively as they are better drivers of audit quality (see the responses to question 11 and 13 below).

Question 7

In relation to financial penalties are they being set at the right level?

In answer to this question, respondents are invited to state;

(a) whether they think they are too low or too high, and

(b) by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.

Response - Question 7

The FRC's sanctions are large compared to those in other countries. The PCAOB has only imposed a fine of more than £2m once and as far as we know, no sanctions have been imposed on firms by audit regulators in relation to individual engagements in Australia, Canada or the Netherlands.

The financial penalties are already very high, and increasing them any further may have negative unintended consequences as set out in our covering letter and response to question 10 below.

The impact of the existing sanctions regime on member firms and individuals can be very punishing. By way of example, the FRC finding against Deloitte in respect of the audit of Aero Inventory Plc included a fine of £4m, plus a severe reprimand, plus contributions to FRC costs of over £2m, plus Deloitte's own legal and internal costs of a similar amount. We estimate that this represents approximately 15% of the annual operating profit Deloitte earns from performing statutory audits (based upon Deloitte's 2016 financial statements).

This is a high financial sanction not only as a standalone amount but also as a multiple of fees earned which in total over the 3 year period of the complaint were under £0.6m for audit and a similar amount for non-audit work.

In addition, a finding against an audit partner is very often career ending due to the public nature of the finding and the duration of the investigation.

Question 8

If respondents think that financial penalties are too low is this because:

(a) failures of the type covered by the procedures require greater censure than is currently given;

(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;

(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;

(d) they do not promote public confidence; or

(e) some other reason?

Response - Question 8

The financial penalties are already very high. Increasing them any further may have negative unintended consequences as set out in our covering letter and response to question 10 below. We have also explained our view that financial penalties are not drivers of audit quality.

Question 9

What are the key elements in achieving effective deterrence?

Response - Question 9

Deterrence is just one of the objectives of the FRC's sanctions regime and we are concerned with the weight that it is given compared to the other objectives. Our view is that the focus should be on audit quality as this is paramount to generating trust and confidence in capital markets. Sanctions should be directed towards improving quality and recognise the potential unintended consequences that might arise if they are too high or misdirected.

Question 10

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

Response - Question 10

No. As set out in our response to question 6, we do not believe that financial sanctions are the key driver of audit quality.

One of the drivers of audit quality is the quality of the audited company's corporate governance and their financial processes and systems. There is a risk that the largest firms may increasingly avoid auditing riskier companies. Increasing financial sanctions will exacerbate this effect, increasing risk in the market, which would be counter to the FRC's overriding objectives. It might also reduce competition in the audit market, as smaller firms will not be able to justify auditing PIEs if a single FRC fine could wipe out all or a significant proportion of their annual profit.

A further unintended consequence is that, under the current regime, high sanctions decrease the attractiveness of the audit profession. This is for two reasons:

- Although we have no sympathy for auditors who are dishonest, lack integrity or cut corners, all too often very capable audit partners are prosecuted for errors of judgement. This, together with the length and public knowledge of investigations, not only damages careers but can and often does have a serious impact on mental wellbeing. It also deters talented younger auditors from remaining in the profession or aspiring to become audit partners. There is a real risk of a "brain drain" out of the profession post qualification, an effect that may only be properly appreciated several years in the future.

- Sanctions can have a real impact on the profitability of audit practices. This can push existing auditors towards working in more profitable advisory services once they have qualified. The FRC has already expressed its fear that audit may become of lesser importance in firms compared with other services. Increasing sanctions makes this more likely and could, in the extreme, lead firms to exit segments of it altogether.

Question 11

Should there be greater use of non-financial sanctions such as:

(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or

(b) an order for some form of restitution?

Response - Question 11

We believe that other sanction options would be better drivers of audit quality than large financial penalties and the FRC guidance could be improved to encourage the use of other options. Currently the existing sanctions guidance allows the FRC/tribunals to use certain conditions as a method of sanction, such as the implementation of education or training programmes or investment in tools and methodologies with external monitoring. We are not aware of any instances where this has occurred, although we believe that they could be very effective and could make a real difference.

We note that this method is used extensively by the AQR and it is extremely effective because the feedback is received on a timely basis and therefore firms can use this to make improvements to processes without long drawn-out disciplinary processes.

A possible alternative solution for financial sanctions could be to require firms to spend a proportion on remedial action (such as enforced training or investment in specific initiatives) that addresses the underlying cause of the breach.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance[3], as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

(a) operating satisfactorily; or

(b) inappropriate, and, if so, why?

Response - Question 12

Overall we believe that the FRC's current guidelines for settlement discounts are appropriate.

One way in which the system could be improved in our view would be to have more meaningful settlement discussions, possibly in the form of a mediation, before a formal complaint is finalised.

Question 13

Are there some sanctions which could usefully be imposed which are not currently available?

Response - Question 13

We believe some alternative sanctions to financial penalties that could be explored by the FRC include:

- The FRC could expand their AQR inspections in response to a disciplinary finding which the firm could be obliged to pay for; and
- There could be more enforced training, not necessarily restricted to the audit practice, recognising that education is more beneficial longer term than taking a financial sanction.

[3] At paragraphs 58 to 63 of the Actuarial Scheme Sanctions Guidance

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Building a better working world

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30 June 2017

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Dear Noranne,

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions: Review Panel call for submission

1. We welcome the publication of the *Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions: Review Panel call for submissions* and the opportunity to provide input to the Review Panel. This is a very important topic and we commend the Financial Reporting Council (FRC) for launching an independent review, with a terms of reference that includes gleaning views and insights from the many and varied stakeholders.

2. We have set out, in Appendix I to this response, our answers to the specific questions raised by the Review Panel in the call for submissions. Our key points and more detailed thoughts on the FRC's enforcement sanctions follow below.

3. In this response we use the term "*member of the professions*" to refer to auditors, accountants and actuaries and "*member firm*" to refer to audit firms licensed by the recognised professional bodies. Unless stated otherwise, our response refers to members of the professions in practice rather than industry, and to audit partners and actuaries (unless the context provides otherwise).

Scope of FRC sanctions

4. As an overarching comment, we agree that it is, of course, appropriate that work that falls significantly short of standards reasonably to be expected is subject to regulatory scrutiny and sanction. Partners in an audit firm such as EY are required to be members or associate members of the recognised professional body that licenses the firm – in our case the ICAEW. As a result, all partners of the UK firm are within scope of the Accountancy Scheme. Whilst the FRC's Audit Enforcement Scheme concerns audits of public interest entities (PIEs), the FRC may take action against an audit firm and/or its individual partners for misconduct in public interest cases arising from professional activities outside of PIE audits. In our view it is vital that all partners – and indeed all members of the professions (including those in industry) - are held to the same high standards regardless of the type of service they provide. As a result, we think it is important that the future of the Accountancy Scheme – which we assume will continue to be the FRC's responsibility - should be considered as part of this review.

5. As we discussed in our May 2016 response to the FRC's *Enhancing Confidence in Audit: the Financial Reporting Council's Audit Enforcement Procedure* consultation document, it is important that auditors alone are not seen as the only culpable persons when a corporate scandal or failure occurs. Although the EU definition of public interest is relatively narrow and the scope of the proposed Audit Enforcement Procedure is defined by reference to entities and breaches of requirements in the Statutory Audit Directive (as revised) and Statutory Audit Regulation, we stated in our response that we believed it would be a retrograde step not to include the FRC's wider public interest role in relation to the accountancy profession as a whole – including the protection and maintenance of public trust – in a streamlined Enforcement Procedure. We remain of this view. In our opinion, the reputation of corporate reporting and corporate governance is equally important to the public interest as the reputation of audit – and often more so. Therefore, we believe that the FRC should operate one enforcement procedure and have one sanctions policy, differentiated as appropriate for different types of cases - including cases under the Accountancy Scheme and the Actuarial Scheme, as well as PIE audits under the Audit Enforcement Procedure.

6. As regards the scope of the Accountancy Scheme, we recognise that there is currently an unlevel playing field in industry as the FRC can only take action for misconduct against members of the ICAEW, ACCA, ICAS, CIMA, CIPFA or the CAI and not all individuals performing comparable financial reporting roles (for example, finance directors who have chosen not to maintain their membership of a professional body). We believe that, in principle, there should be the same level of accountability for all individuals performing key financial reporting roles at PIEs within the FRC's purview. However, we are aware that this issue is outside the scope of the current review and, to resolve it, the FRC may need additional powers and a different enforcement mechanism.

Factors giving rise to misconduct

7. There is clearly a spectrum of behaviour that can result in a member of the professions or an audit firm facing FRC sanctions: ranging from dishonesty at one extreme through negligence to an inadvertent mistake. At the dishonest end of this spectrum, justice clearly needs to be done and be seen to be done to root out the "bad apples" and safeguard confidence in the profession and protect the public and the wider public interest.

8. Sector/conduct regulators, often deal with cases of deliberate or intentional, often profit-driven, misconduct. Hence, to protect the public, their sanctions must be sufficiently severe so as to ensure that the risks of deliberate decisions to flout the rules far outweigh any financial benefit (which may be the subject of disgorgement) and a clear deterrent message is sent. Where members of the professions and/or member firms engage in deliberate or intentional misconduct - such as demonstrating a lack of integrity, dishonesty or criminality – we support proportionally severe sanctions (such as removal of an auditor's practicing certificate).

9. It is our experience though that, in the majority of cases, breaches do not arise from pre-meditated behaviour and the members of the professions generally do not intend to commit misconduct or know at the time that their actions would amount to misconduct (i.e. they do not have a guilty mind or *mens rea*). Disciplinary cases involving members of the professions often relate to unintentional oversight or well-intentioned errors of judgment on matters of fine sensitivity, inevitably judged with hindsight, with a range of underlying causes. Hence we believe that there should be a distinction

between pre-meditated conduct with *mens rea* and unintentional mistakes, particularly those that occurred despite a member of the professions trying to do the right thing (e.g. judgements that were honestly made but with hindsight flawed) but where circumstances conspired against them.

10. Sector/conduct regulators also deal with cases where the systemic failure of a firm's internal controls is the direct or indirect cause of a breach. In our view, the respective responsibilities of members of the professions and member firms need to be considered on a case-by-case basis. Decision makers clearly have to consider the role of a member of the professions and the extent to which a member firm is involved in the breach. For example, where there has been audit failure, a sanction on a member firm should be decided only when the FRC has determined that it is caused by, for example, a collective failure. However, it is important to be mindful of the pressures on members of the professions, which are very different to the pressures on member firms and exacerbated by a lengthy enforcement/disciplinary process, and aware of the risk of inadvertently sending a message that judgmental, technically challenging work carries a higher personal risk (and hence is seen as less attractive).

11. To protect the public interest and maintain confidence in the profession, we believe that, absent deliberate and intentional wrongdoing, the focus should be on identifying and rectifying the cause of a breach and seeking to prevent its recurrence expediently, rather than on punishment and deterrence particularly through focussing on the application of financial sanctions, the longer term effectiveness of which, in relation to cultural and governance change, is largely unproven.

The FRC's toolkit of sanctions

12. In our opinion, the FRC needs to make better use of a flexible and more extensive toolkit of sanctions to ensure that the sanctions imposed on member firms and/or members of the professions align with the objectives the FRC is seeking to achieve. Use of such a toolkit would be consistent both with the protection of the public interest and the FRC's overall objective of ensuring that the market has confidence in the quality of corporate governance and standards of professional practice. We believe that different elements of the FRC's objectives and desired outcomes might be better achieved by the use of different, but not necessarily monetary, sanctions or combinations of sanctions.

13. The FRC's current guidance to both the Accountancy Scheme and Audit Enforcement Procedure states that the "primary purpose of imposing sanctions" "*... is not to punish but to protect the public and the wider public interest*". Sanctions under both schemes are imposed to achieve a number of other purposes - for the Audit Enforcement Procedure these include deterrence, the maintenance and promotion of confidence in the profession and the declaration and upholding of proper standards amongst members of the professions. It is, however, important that the FRC, member firms and other stakeholders are clear on the objectives the FRC intends to achieve from sanctions in specific cases i.e. are they seeking to rehabilitate members of the professions or deter and hold them (and/or member firms) to account – or a combination of both depending on the facts and circumstances?

14. We believe that the overall objectives of the FRC sanctions regime warrants further debate with stakeholders. For example, if the objective is to improve audit quality then the emphasis should be on remedial action by the member firm, with a temporary suspension of their ability to tender in

egregious cases, and the early communication, by the FRC, of any lessons learnt to other member firms and members of the professions to prevent a reoccurrence of the breach.

15. In our opinion, the first step in making sanctions effective should be a root cause analysis to understand the combination of factors that led to the breach e.g. *why did it happen? What was the behaviour of the member of the professions and how did it fall significantly short of standards reasonably to be expected? What were the contributory factors?* This root cause analysis could be carried out by the member firm, the FRC or an independent third party depending on the seriousness of the breach. Sanctions could then differ in light of this analysis, depending on the FRC's desired outcomes, the split of responsibility between the member of the professions and the member firm and other factors. A root cause analysis would also:

    - make sanctions as specific and reflective as possible of what went wrong, so they are proportional to the degree of blameworthiness. For example, requiring an audit partner or an actuary to retrain and/or imposing a periodic suspension on any practicing certificate, or, in the case of actuaries, chief actuary certificates. As discussed above, though, due to the current lack of a level playing field, a finance director who is not a current member of the professions might bear a significant level of responsibility for any failures.

    - assist with the content of any remedial training (for example of a partner, an audit team or an actuary) who may be exposed to similar issues in future.

    - identify potential lessons to be learnt so, once there has been a finding of a breach, the FRC could use practice alerts, speeches etc. to inform member firms and members of the professions of the issue and how it is viewed by the FRC, to seek to ensure that it doesn't reoccur.

16. We believe that the approach used by other professional regulators could be informative to the Review Panel, as whilst high monetary sanctions undoubtedly do make the headlines, they do not have as much impact on unintended behaviours that lead to a breach as targeted, non-financial sanctions (such as retraining).

17. Another benefit of a more extensive toolkit of sanctions that better fits the nature of the breach, is that it might encourage member firms to cooperate and settle cases. Whilst internal controls are regularly tested and monitored (both internally and externally), it is near impossible to eradicate errors, as judged with hindsight, in services which involved judgments on matters of fine sensitivity. We therefore support the current sanctions policy that includes a firm's poor disciplinary record as an aggregating factor in the sentencing process.

18. In our opinion it is important – for member firms, members of the professions under investigation, as well as for other stakeholders – that the FRC enforcement/disciplinary procedure is expedited. We recognise that the FRC is hoping to improve the timing but we would suggest that the Review Panel considers the timing of other disciplinary/enforcement procedures and how to enhance the timeliness of the FRC's sanctions - particularly where positive action needs to be taken to rectify what went wrong, prevent reoccurrence and protect the public – and the reporting of the sanctions to other stakeholders, without foreshortening due procedure.

Non-financial sanctions

19. We believe that financial sanctions are not the only or indeed the best driver of change. From the EY Audit Quality Programme, we have learnt that the most substantive change in FRC inspection results can be achieved through a long term behavioural change programme, rather than simply relying on sanctions. Our Programme is supported by: a root cause analysis to fully understand the causal factors which drove any poor results to enable us to target change programmes accordingly; and cognitive behavioural analysis to help achieve better quality outcomes. Hence, in our view the FRC's toolkit should include the following non-financial sanctions:

Sanctions against members of the professions

- *Reprimands*

  We note that reprimands are quite common in Germany as a sanction for "*first time*" offenders, or in general, in less severe/material cases. We believe that reprimands remain an appropriate tool for breaches that do not involve premeditation or *mens rea*. A previous reprimand will also be an aggravating factor in sanctioning any future breaches, which we agree is appropriate.

- *Mandatory retraining*

  This would be particularly helpful where additional training would rectify a technical deficiency or help change a behaviour that lead to the breach. For example, an actuary could be required to attend the Professionalism Skills Course.

  Anecdotally, though, we are aware that most individuals who have been subject to FRC sanctions do not remain in the profession – possibly as a result of the time it can take for cases to be brought. We are also aware, from training delivered in other areas, that the personal story of an individual who was doing their job 'just like everyone else' but made a mistake/got things wrong and paid a price can send a very powerful and effective – "*there but for....*" message to audiences. In our view, rehabilitating members of the professions in such a way as to enable them to continue their careers could have additional benefits.

- *Suspension of a member of the profession's registration for a given period*

  This sanction, which is used by audit regulators in Singapore, could be utilised in cases where the behaviour of an auditor, rather than the firm, led to a breach and the misconduct is such that the public interest needs to be protected by preventing the individual carrying on as normal.

- *Suspension of a member of the profession's actuarial practicing or chief actuary certificates for a given period*

  This could be utilised in cases where the behaviour of an individual actuary led to a breach and the misconduct is such that the public interest needs to be protected by preventing the individual carrying on as normal.

Sanctions against member firms

- *Remedial action plan*

  Using the root cause as a foundation, member firms should be required to develop and publish remedial action plans setting out the steps they will be taking. The FRC could audit these plans and publish its own report, or the member firm's senior management could self-certify the plans publically.

- *Mandatory investment*

  In connection with a remedial action plan, member firms could be required to make a mandatory investment in, for example, additional training, systems and controls (such as greater EQR) and audit quality (e.g. greater and higher quality human resources) and publically report compliance.

Sanctions against member firms in egregious circumstances

- *Suspension or restriction of practice*

  Suspensions and restrictions of practice are used by audit regulators in a number of jurisdictions, including Germany. A member firm might be suspended from taking on PIE clients for a period (e.g. six months) or restricted from taking on clients in certain specialised areas/sectors.

  However, we believe that this sanction should be considered only in the most serious of circumstances where a pattern of failure to take remedial steps demonstrates a cultural/tone issue such that a firm is unable to take effective remedial action to resolve the root causes of breaches. Care would also need to be taken to avoid unintended consequences, for example, suspension of practice could, potentially, penalise a corporate by restricting their choice of new auditor or non-audit services provider and, if it were to lead to the demise of the member firm, unduly limit competition in the audit market.

- *Installation of a monitor*

  In relation to anti-bribery and corruption, there have been interesting discussions about whether high fines are the way forward or whether monitorships and the extent of the remedial action that member firms are required to take results in substantial changes within the member firms by the end of the process. Monitorships (i.e. the appointment of an independent 3rd party to monitor and report on a firm, including its key senior executives, for a set period, often as part of a Deferred Prosecution Agreement) are also used effectively in anti-competiveness cases.

  We believe that monitorships should be reserved for the most egregious of circumstances where a regulator has strong reason to believe that a firm cannot resolve its own problems. In these circumstances, monitorships, perhaps linked to the role of INEs in relation to audit quality, could be instrumental in helping to drive governance and cultural change by giving the firm an opportunity to learn new behaviours (or face harsher consequences) instead of management change. However, it would be important to learn

lessons from other jurisdictions and ensure that the process would not leave firms weakened and, hence, more vulnerable.

While some regulators have the power to replace management, the wholesale removal of seasoned management could have a devastating impact on a member firm, and put the member firm at risk of failing. While there may be circumstances where such an extreme remedy may be warranted, it should be limited to situations of recurring widespread wrongdoing within a member firm, where management has set the wrong tone, and they have been unable or unwilling to facilitate remediation and a monitor has been installed but has not been able to drive the necessary cultural and governance changes i.e. it should be a tool of last resort if monitorship fails.

Financial sanctions

20. Large financial sanctions are often used by conduct regulators such as the Financial Conduct Authority (FCA), in particular to protect consumers. Professional regulators, however, generally impose lower monetary fines but protect the public by focussing on, depending on the degree of seriousness of the breach, retraining, suspensions or, ultimately, striking off individuals. We believe that it may be helpful for the Review Panel to explore how one of more of the professional bodies use non-financial sanctions in more detail.

21. In professional services, disciplinary action and the resulting reputational damage can have a greater impact than a fine, particularly when the professional is self-employed and their ability to win work rests on their good reputation. In general, members of the professions do not intentionally put their careers at risk but rather make mistakes as a result of errors of judgment or because they are too busy and/or have limited resources (i.e., the breaches are generally without premeditation and *mens rea*), therefore, a fine in itself, even if high, may not change behaviour effectively. Hence the importance of retraining for both the member of the professions and, where appropriate, their member firm. The impact of an investigation on an individual's reputation and health is also often greater than a financial fine.

22. We recognise, of course, that there is a place for financial sanctions in the FRC's toolkit. However, we believe that the FRC should develop an enhanced policy on the calculation of these sanctions that considers, for example, the findings of the root cause analysis, the seriousness of the breach, whether there was *mens rea*, the actual or potential impact of the failing on those could be caused detriment, the degree of cooperation with the FRC and the degree of remediation since the event.

23. Whilst we recognise that large financial sanctions generate headlines, we would also caution against unintended consequences including dis-incentivising mid-tier member firms from growing their audit practices and possibly reducing choice of auditor for clients who are perceived as higher risk (e.g. where there are greater uncertainties around provision, management and/or systems and controls) and causing funds that would otherwise be spent on training and other remediation instead being diverted to meet financial sanctions.

Sanctions scope, policy and guidance

24. We believe that a more meaningful distinction could be drawn between the culpability of members of the professions and the management and control failings of member firms that could exacerbate or lead to individual breaches. In our opinion, the FRC should consider the balance of responsibilities based on the facts and circumstances of each case. Although it is right that firm-based sanctions hold the firms accountable, such sanctions should in our view be considered only when the root cause of a matter is an institutional failing. For example, where a member firm has appropriate policies in place and provides effective training, but a member of the professions chose not to follow those policies, it seems unlikely that imposing sanctions on the member firm in those circumstances would be effective in remediating the root cause (i.e. a deliberate act by the member of the professions). However, particularly in audit, unless there has been a rogue partner, sanctions on member firms would make them more accountable (for example, for their systems and controls and resourcing decisions) and alleviate stress from the individual concerned, who may simply have made a mistake.

25. As discussed previously, we also think that there should be a distinction between pre-meditated conduct with *mens rea* and unintentional mistakes, particularly those that occurred despite a member of the professions trying to do the right thing (e.g. judgements that were honestly made but with hindsight flawed) but where circumstances conspired against them.

26. In addition, in determining a sanction against a member of the professions, many regulators (e.g. in Germany) consider any actions (non-financial or financial sanctions) taken by the member firm against the individual to determine whether any further sanctions would be needed. This approach underscores that it is primarily the member firm's responsibility to encourage compliance and to sanction non-compliance where necessary. Likewise, we believe that further factors in determining the sanction imposed on a member firms should include any remedial actions that have already been taken, such as investment in audit quality, training, changes in policies etc. and, as discussed previously, the actual or potential impact of the failure on those who could be caused detriment (for example, the stakeholders and markets).

Timeliness of sanctions

27. It is vital for public trust in the audit, accountancy and actuarial professions that the FRC is, and is perceived to be, an effective regulator. Currently, enforcement proceedings can take between 5 and 7 years after an audit report is signed to reach a conclusion (or longer for cases that go to the Tribunal). We believe that the lead time between a breach and the final sanction is too long and there should be speedier resolution of cases whilst following appropriate due procedure.

28. In our view, the FRC should pursue strong, public interest cases quickly and carry out a focussed and expedient investigation as early as possible, including, as discussed in paragraph 15 above, a root cause analysis. An expedited enforcement process would, in our view:

    - mitigate the human impact on partners of defending a case for so many years (currently, very few auditor partners are still working at their firm when action is taken, which reflects the pressure on individuals as well as retirement).

- ensure that lessons are learnt – by the partner, firm and industry – as soon as possible (which could be facilitated if the partners involved were available to recount their stories as part of the training).

- help satisfy other stakeholders with an interest in the case. This is particularly relevant for cases against finance directors following accounting irregularities that have affected a company's share price or resulted in the company's insolvency.

Stakeholder communication and sharing lessons learnt

29. We would like to see the FRC provide a separate plain English communication on sanctions for the media and other stakeholders that explains what went wrong, why it happened, the consequences of the breach for the relevant stakeholders, what the FRC and the individual/firm did to prevent a recurrence and the sanctions levied.

30. We would also like to see the FRC share any potential lessons to be learnt, and their expectations, with members of the professions and audit committees once there is a finding of a breach. For example, so other member firms can benchmark their systems, controls and processes and, if necessary, take action. The root cause analysis and remedial plan discussed under non-financial sanctions would assist in this process as they would help to highlight what caused the problem, what action was taken and, possibly at a later date, whether it worked. As discussed above though, it is important that this communication is timely, otherwise firms and members of the professions may take the view that "that was then and we've all changed now", without focussing on the root causes and whether the changes have mitigated or prevented the same or a similar problem arising in their firms. The communication also needs to bring out the key messages for firms and the FRC's expectations to avoid a "we'd never do a thing like that" reaction.

31. Greater coherence and making sanctions better fit the breach should align better with the FRC's objectives and, hence, hopefully, enhance the trust of other stakeholders.

32. We hope that our comments will be helpful in your review. Should you wish to discuss any points in more detail, please do not hesitate to contact me.

Yours sincerely

Robert Overend, Partner
Ernst & Young LLP

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Appendix I: Responses to questions in the Call for Submissions

Q1: Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

The objectives set out in paragraph 9 of the Sanctions Guidance for the Accountancy Scheme (which are the same in the Actuarial Scheme Sanctions Guidance) are set out in Appendix 2. The objectives of the Audit Enforcement Procedure specifically in relation to sanctions are encapsulated in paragraphs 11 and 12 of the Sanctions Policy (Audit Enforcement Procedure) which are, also, set out in Appendix 2.

See paragraphs 12 to 13. We believe that the current objectives, particularly the primary objective to protect the public, are satisfactory. The objectives sit well with the FRC's wider role and ensuring confidence in the profession and should not, in our view, be extended to punishment. It is also important that there is a clear distinction between regulatory duties and objectives and the civil law remedies against a member firm, or member of the profession, that are available for loses suffered as a result of negligence.

Q2: Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:

(a) Guidance, either of the current of some other type

(b) Some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or

(c) Some form of guidelines which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.

See paragraphs 24 to 26. In our view, the key test of whether the Sanctions Guidance/Policy is satisfactory and fit for purpose in the current circumstances is whether its application results in outcomes that are clear and understandable, in particular, sanctions that fit the breaches and clearly align with FRC's objectives. It is vital that stakeholders understand the FRC's sanctions regime, believe it will work and have confidence that effective sanctions will be imposed on a timely basis.

We would, for example, be supportive of additional guidance that provides greater clarity and focus on the behaviours which are properly the subject of disciplinary and enforcement proceedings and sanctions. We believe that this guidance should reflect the difference between pre-meditated and/or intentional behaviours and recklessness and mistakes. We believe that the range of sanctions, particularly non-financial sanctions, which could be applied to the last category should different or be more extensive. For example, by analogy, the National Speed Awareness

Courses is only offered, if considered appropriate, to drivers detected as driving within the range (10% plus 2mph) to (10% plus 9mph) over the speed limit.

Q3: In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form or tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

In our opinion, there are insufficient numbers and types of cases to make a tariff relevant. Sanctions need to be determined on a case-by-case basis, as the facts and circumstances are often complex and sanctions need to be tailored to best fit the FRC's objectives.

Q4: In imposing sanctions, should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

See paragraph 10. In our view, the responsibilities of members of the professions and member firms need to be considered on a case-by-case basis.

Q5: In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

If respondents think the FRC should establish some starting point, they are invited to articulate:

(a) How they consider that starting point should be measured for entities or individuals (e.g. by reference to specific monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);

(b) How the starting point should be determined

(c) What criterion/a should produce what starting point(s).

We do not think that there should be a fixed starting point for financial penalties. In our opinion, the FRC should calculate any financial penalties based on the facts and circumstances of a case, using a set of steps to standardise the calculation and including mitigating factors such as investment in remediation plans, previous disciplinary history etc.

This would be consistent with the AADB Tribunal's findings in the 2011 JP Morgan Securities Limited Client Money case in which the Tribunal considered the relevant principles for utilising an unlimited power to impose financial penalties[1]. The principles include that it is not possible to assert that a fine should stand in any specific relationship with turnover or net profit of the defendant and each case must be dealt with according to its circumstances. We are also aware

[1] The principles were stated in R v Howe & Co (Engineers) Ltd [1999] Cr App Rep (s) 37 cited in R v Balfour Beatty Rail Infrastructure Services Ltd [2006] EWCA Crim 1586

that in *Connaught* case, the Tribunal did not consider previous decisions to be particularly helpful in deciding the level of sanction.

A one size fits all approach to sanctions based on a percentage of revenue, turnover or profit for all types of misconduct would, in our view, be too rigid and prone to challenge as inconsistent and/or disproportionately as it could result in high fines for lower level misconduct where the conduct in question may not give rise to a liability in negligence. We also think that fines based on annual revenue has the potential for a number of unintended consequences, for example:

- the same misconduct will result in different financial penalties depending on the member firm involved
- firms that may be most at risk of high fines may be less profitable firms with fewer resources that have underinvested in risk management systems and procedures and legal and compliance teams, operate on smaller margins and have fewer partners to spread the financial penalty – hence higher financial penalties could disincentivise smaller firms from expanding and/or providing new services
- there could be reduced competition in the market if firms decide that certain audits or other professional services are deemed to be unacceptably high risk
- revenue/turnover is, of course, not evidence of a member firms' ability to pay – particularly if they have also invested in a remedial plan - and it would be important to recognise the "*relevant revenue*" i.e. "*the revenue derived by the firm during the period of the breach from the… business areas to which the breach relates.*"[2] For example, in the case of sanctions relating to an audit, relevant revenue would be audit revenue during the period of the breach, which could be significantly different to total revenue or audit revenue at the time the case is brought.

Q6: To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

To answer this question fully, we believe that the FRC should consider the evidence of the present and determine whether, including by reference to past cases of misconduct, they believe that current sanctions are improving standards in the professions. For example, the degree to which recent cases have caused member firms to think more broadly about their public services responsibilities and possible conflicts?

We think, however, that the FRC should make greater use of non-financial sanctions that better fit the breach and align the primary aim of protecting the public. For example, through imposing corrective action to rectify current issues and prevent a recurrence. We note that other professional services regulators and a number of overseas audit regulators (such as the ACRA in Singapore) use non-financial sanctions such as education, supervision for member firms, third party reviews and prohibitions on accepting new clients. Also, notifications and reprimands are quite common in Germany as a sanction for "first time" offenders, or in general, in less severe/material cases.

[2] See the FCA Decision Procedures and Penalties Manual (DEPP) 6.5A: The five steps for penalties imposed on firms

Q7: In relation to financial penalties are they being set at the right level?

In answer to this question, respondents are invited to state:

(a) Whether they think they are too low or too high; and

(b) By what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.

We believe that this question is best answered from the evidence base discussed in Q6 above. If there is no evidence that inadequacies in the FRC financial sanctions are causing continued (or a rise in) misconduct or the professions are failing to respond to sanctions in an appropriate manner, then this would indicate that financial penalties are not set at the wrong level.

Intentional and profit-driven misconduct needs a sanction regime which imposes substantial fines on companies – including the disgorgement of substantial profits from the misconduct – to deter future misconduct.

As far as we are aware, though, there is no culture of deliberate or intentional profit-driven misconduct in the professions. Instead, as discussed in paragraphs 7-11, it is our belief that the majority of breaches arise from errors of judgment (as judged with hindsight) or breaches of standards with little or no causative effect. It would seem to us that such well-intentioned judgment errors are inherently incapable of being deterred by higher fines, as there is no deliberate decision to commit a breach that could be influenced by the increased risk. In our view, breaches that are not premeditated or involve *mens rea* may best be addressed by a more holistic approach to sanctions.

Q8: If respondents think that financial penalties are too low is this because:

(d) Failures of the type covered by the procedures require greater censure than is currently given;

(e) They are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failure being sanctioned;

(f) They are insufficient to incentive either high quality audit work/compliance with rules, regulations and standards;

(g) They do not promote public confidence; or

(h) Some other reason?

See our response to Q7 above.

Q9: What are the key elements on achieving deterrence?

As discussed in paragraph 13 et seq, to achieve credible deterrence the FRC and member firms need a detailed understanding of what went wrong and the factors that led to the misconduct / mistake (i.e. a root cause analysis) and the sanctions need to be appropriate, reflective of the misconduct and include corrective action to prevent a recurrence.

In our view, an emphasis on financial sanctions – and a member firm's financial resources – risks the loss of perspective on the nature and cause of the misconduct and the degree of the departure from accepted practice.

It is also vital that once a case is decided, the FRC communicates clearly the lessons to be learnt, the action it took and why, and its expectations, to other member firms and members of the profession.

Q10: Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

As discussed in paragraphs 29 to 31, we believe that stakeholders need to have a clear understanding of, and the FRC needs to communicate clearly:

- what went wrong and why it went wrong (from the root cause analysis)
- where applicable, the action that was taken by the member firm to rectify and prevent a recurrence (i.e. the remedial plan)
- the non-financial and/or financial sanctions imposed by the FRC and how they are designed to meet the FRC's objectives in the specific case
- lessons to be learnt for other member firms and members of the professions

Whilst fines are well understood by the public, there can be cynicism about their effectiveness regardless of the level at which they are set. In appropriate cases that do not involve pre-meditation or *mens rea*, we believe that a more holistic use of non-financial sanctions that are designed to change behaviour (i.e. tailored, corrective action to protect the public) would be more effective for promoting public confidence.

Additionally, to promote good behaviour and public confidence it is important that there is a speedier resolution of cases, whilst following appropriate procedures, so that stakeholders see timely and positive action being taken by the regulator and members of the professions and members firms receive timely and relevant communications from the FRC on lessons learnt and regulatory expectations.

Q11: Should there be greater use of non-financial sanctions such as:

(i) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas of requirement for further training; and/or

(j) an order for some form of restitution?

Yes, as discussed in paragraph 19 et seq. we believe that there should be greater use of non-financial sanctions in appropriate cases (i.e. cases not involving premeditation and/or *mens rea*).

In most cases we think that there will routes open to stakeholders who have lost money as a result of a breach to seek redress from the member firm. As discussed in response to Q1 above, we believe that it is important to maintain clear distinctions between regulatory sanctions / enforcement and civil claims. However, an order for some form or restitution might be relevant in the limited cases that involve loss to stakeholders who, practically or for legal reasons, find it difficult to take action against the member firm. We recognise, though, that proving the extent of the losses could create a significant additional workload for the FRC.

Q12: The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraph 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

(a) Operating satisfactorily; or

(b) Inappropriate, and, if so, why?

We have no comments at this time.

Q13: Are there some sanctions which could usefully be imposed which are not currently available?

Yes, see the non-financial sanctions discussed in paragraph 19 et seq.

Grant Thornton

An instinct for growth™

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Sent by post and email
30 June 2017

Dear Sirs

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Independent Review of the Financial Reporting Council's (FRC) Enforcement Procedures Sanctions.

The primary purpose of imposing sanctions for breaches of relevant requirements is to protect the public and the wider public interest and we agree with this objective. To achieve this purpose the regime has to be effective, proportionate, transparent and fair to all parties concerned. It should act as a deterrent to deliberate wrongdoing and contribute to improving quality across the profession for the benefit of trust and integrity in markets.

The FRC administers a number of enforcement procedures including the Accountancy Scheme, the Actuarial Scheme and the Audit Enforcement Procedure, and related sanctions. However, when one looks at Appendix 3 of the Consultation Document, 'The Schedule of AADB and FRC cases and sanctions from January 2009', almost all of the findings of misconduct arise from audit work and therefore our response focuses on the audit market and related enforcement procedures and sanctions.

We attach our response to the detailed questions raised in the consultation and highlight our key observations below.

The objectives of an enforcement regime

Firms and regulators collectively seek to maintain and promote public and market confidence in Statutory Auditors and Statutory Audit firms.

Specifically, the role of regulator should be to drive improvement in quality for the benefit of trust and integrity in markets. The regulator must be seen to take its responsibility for promoting high quality audit seriously through the investigation process, and that process should be robust.

Sanctions should therefore be designed to support this drive for improvement and support firms in identifying the root causes of failings and sharing the findings across the profession so as to ensure that similar failings do not happen again.

To achieve this outcome we believe the enforcement regime must:

- make use of all available sanctions which have the effect of delivering improvement
- be transparent and fair and not simply focus on financial penalties
- ensure findings are communicated on a timely basis so that lessons can be learned so as to prevent future failures, on a firm-wide and profession-wide basis as soon as possible.

Our observations on the current enforcement regime and sanctions

Market competition

A key principle of the FRC's 2016/19 strategy and 2016/17 plan, is that audit is a sustainable business with adequate capacity, and sufficient levels of competition and choice. However, the presence of firms in the audit market for public interest entities (PIEs) is not guaranteed and there have been no recent new entrants to it. The decision to provide services in this market is based on a number of finely balanced factors.

The current heavy emphasis on punitive fines and individual as well as firm sanctions is already having unintended consequences:

- retaining quality individuals in the audit profession is becoming much harder
- punitive fines and protracted investigations undermine the commercial rationale for remaining in the market.

Proportionality and effectiveness of sanctions

We believe that a distinction should be made between deliberate wrongdoing for financial benefit and those situations where there is a genuine error, for example in the case of a complex audit judgement where the individual acted with the best intent yet with the benefit of hindsight came to the wrong conclusion, in other words where there is an 'honest mistake'.

Audit firms do not, for the most part, intentionally commit misconduct. Nor do they profit from their misconduct. Yet there appears to be a current appetite to increase fines. In contrast to intentional wrongdoing, where there is evidence that the level of fines influences behaviour, in the case of unintentional misconduct, an increase in fines would not impact behaviour and would therefore have no effect on the incidence of misconduct. We believe that in this area there is already significant deterrent to poor quality, such as the negative publicity associated with poor AQR findings, the sanctions imposed under the current enforcement regime and most significantly, the prospect of unlimited civil liability in respect of deficient audits.

Financial penalties are often measured by reference to the total turnover or revenue of the firm, regardless of the nature of the breach or misconduct. We do not believe that such a measure of financial penalty is proportionate to the breach. A more equitable basis would be a measure of the revenue or profit generated from the service that gave rise to the breach or misconduct – for example in the case of misconduct in respect of an audit, the audit fee from the client in question, or a multiple thereof.

We consider that a tariff-based framework (similar to the ICAEW's) should be implemented. It could provide a clear and informative basis on which a member of the profession, or the general public, could determine, at least with some approximation, the sanctions that are warranted on a given set of facts. Such a framework can provide a fair and transparent method for determining the sanctions warranted in each case.

The FRC's approach currently focuses narrowly on fines, whereas to achieve its objectives, a wider range of sanctions to include systems, processes and training, should be considered and applied.

Impact on an individual

The impact on the career and wellbeing of individuals subject to sanctions is often far more significant than any financial impact. As soon as the FRC commences an investigation, it is announced publicly. Even if an individual is not named in the initial announcement it is usually easy to identify them as the financial statements of the entity concerned are on public record. There can be a serious impact on the individual's personal and professional career during the extended period of investigation, before any findings are determined.

The current disciplinary approach also deters talented individuals from staying within the audit profession after qualification as the potential consequences of making even one error are often considered by them to be too great. The FRC has a role in ensuring that the audit profession is sustainable through the retention of talented individuals who will become the audit partners of the future.

Length of time taken for an investigation to conclude

It can take many years for an investigation to conclude. This undermines the objective of protecting the public and the wider public interest. Undue delays prevent the lessons from being learned and shared and any mitigation widely implemented within the profession.

The time lag between misconduct and sanctions means that others with a firm, unconnected with the misconduct, often bear the burden of the sanction (financial penalty, reputational damage and so on).

Lack of transparency over what is meant by the 'public interest'

There is a lack of transparency over what is meant by 'public interest' in the context of imposing sanctions. It is unclear what factors drive the FRC's decision to investigate a particular matter and how it determines the cases in which there genuinely is a need to protect the public interest. How does the FRC determine where public confidence has been damaged and an investigation is needed?

Recommendations

We would encourage you to consider the following:

- more emphasis should be given to changing behaviours amongst individuals and firms and supporting ways in which they can learn from their mistakes and improve quality so as to prevent further instances of misconduct or failings in the future
- more use should be made of non-financial sanctions such as those which involve the professional development of individuals and specific commitments by firms to make improvements to processes which are then followed up and monitored by regulators
- there should be more recognition and promotion of good behaviour
- there should be a better understanding of the impact on the individual and greater use should be made of non-public sanctions for less significant breaches where appropriate
- timeframes should be set for conducting an investigation such that lessons can be learned and acted upon both individually and more widely in the profession.

If you have any questions on our response, or wish us to amplify our comments, please contact me.

Yours faithfully

Sacha Romanovitch

Sacha V Romanovich
CEO, Grant Thornton UK LLP

Appendix

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We agree with the declared objectives, which include (in the case of the Sanctions Policy) the improvement of the behaviour and performance of auditors and (in the case of the Sanctions Guidance) the protection of the public.

We note that it is not a stated purpose of the Sanctions Guidance or the Sanctions Policy to punish a firm or individual who committed an error in question, which we think is right.[1]

Sanctions in relation to statutory audit work should be designed and applied for the purposes of improving its quality.

The focus of an enforcement and sanctions regime should be on ensuring that the audit process is robust and that the statutory audit is valued. It should not be viewed as a commodity but as a valuable exercise that is priced appropriately. In our experience, in some cases an audit firm may be selected on the basis of their price and not indicators of quality. Guidance such as the FRC's Audit Quality Practice Aid for Audit Committees encourages Audit Committees to assess the quality of the external audit process and challenge the robustness of the audit, which will further encourage audit firms to have quality at the forefront of their business model. We would like government bodies to take the lead in this respect.

Question 2

Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

No, the Sanctions Guidance and Sanctions Policy fail to provide a framework for the reader to ascertain the sanctions, and in particular the fines, that are appropriate to an instance of misconduct. The FRC's approach currently focuses narrowly on fines, whereas to achieve the objectives a wider range of sanctions to include training, etc should be considered and applied.

The Sanctions Guidance and Sanctions Policy identify aggravating and mitigating factors in relation to sanctions. However, unless a person is familiar with previous disciplinary findings, they would not be in a position to assess the appropriate fine in any given instance. A reader of the Sanctions Guidance and Sanctions Policy would be unable to determine whether the appropriate fine in a given set of circumstances should be £100,000 or £100 million. No information in this regard is apparent from these sources.

At present, fines are determined by reference to sanctions that have been imposed in the past. It is not clear why the decisions to impose the sanctions in those previous cases were made nor how figures for those fines were arrived at. In most cases, the fines in previous cases were agreed between the respondents and the FRC's Executive Counsel, but the reasoning by which they were determined has not been made publicly available. Even in those cases that have come before a Tribunal, which are few in number, no proper explanation has been given for how one figure rather than another has been arrived at. In effect, the fines imposed in relation to previous instances of Misconduct constitute a false tariff, to which reference is made in subsequent cases, yet the lack of a clear or coherent explanation for them means that they are an uninformative and unreliable point of reference. This situation is far from satisfactory.

[1] In the Sanctions Guidance, the word 'misconduct' is used, whereas the Sanctions Policy generally uses the word 'breach.' In this response, each term is used, depending on the context.

We consider that a tariff-based framework (similar to the ICAEW's) should be implemented. It could provide a clear and informative basis on which a member of the profession, or the general public, could determine, at least with some approximation, the sanctions that are warranted on a given set of facts. Such a framework can provide a fair and transparent method for determining the sanctions warranted in each case.

Questions 3 and 5

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

In relation to fines, should the FRC establish some starting point in respect of both individuals and entities?

For the purposes of a tariff, we consider that regulatory offences should be divided into two principal categories for the purposes of determining sanctions:

1. **intentional misconduct,** including reckless misconduct; and
2. **unintentional misconduct.**

There ought to be different procedures for applying sanctions in each such case.

As to **intentional misconduct,** a wrongdoer typically weighs up the expected costs and benefits of committing it. One study[2] suggests that the probability of conviction and the punishment if convicted will have an impact on the offences that an individual would be prepared to commit. An increase in the risk of detection or an increase in the severity of punishment would generally reduce the number of offences committed. A fine is an important deterrent in such a case. Fines should be imposed for intentional misconduct with the need for deterrence in mind.

As to **unintentional misconduct,** which is committed inadvertently, an increase in fines would have no effect on the incidence of misconduct, or at least no effect that bears any proportion to the incremental effect of deterring wrongdoing. In many regulatory regimes, fines are calculated by reference to the proceeds of the wrongdoing but, as to the commission of unintentional misconduct in the conduct of an audit, there are no such proceeds. An auditor who makes an honest error in performing an audit does not gain a financial benefit from doing so. In fact, errors are liable, as all auditors know, to bring undesirable consequences down upon them. There are no proceeds of such an error, unlike, for example, banks who profit from manipulating interest rates or mis-selling products. In the case of an audit, there are no proceeds derived from poor work.

In determining a fine for unintentional misconduct, we consider that the FRC should adopt a starting point by reference to the firm's fee for performing the audit (or a specified multiple thereof) or, if considered a better measure of the misconduct, all fees arising from the firm's relationship with the client in question. Should the misconduct be found to be department-wide, the appropriate measure would be the revenues or profits generated from the relevant department or service-line.

An audit fee is the single datum that best indicates (i) the audit's value to the auditor and client, (ii) the firm's profit from the audit, and (iii) the audit's importance and potential impact on the public interest.

The ICAEW's tariff sets out certain grades of misconduct. For the FRC, we propose grades of unintentional misconduct, including misconduct that is seriously negligent and inadvertent

[2] A paper written by Gary S Becker of the University of Chicago, Crime and Punishment: An Economic Approach, Journal of Political Economy 1968

misconduct. In respect of each such category, the tariff should be graduated to reflect the aggravating and mitigating factors that would apply to the misconduct in question.

We do not consider that fines should be determined by reference to a proportion of the firm's **turnover**. Such a criterion would be unjust and arbitrary because it is irrelevant to the severity of the misconduct. For example, suppose that Firm A performs 1,000 audits, of which all but one are done diligently and to a high standard, but the exception is performed very poorly. In contrast, Firm B performs 50 audits, one of which is done very poorly. Other things being equal, we do not consider that a larger fine should be imposed on Firm A by reason of its larger turnover. There would be no logic to such an approach. In fact, the general quality of Firm A's work in this example is much better than Firm B's.

We consider that account should be taken of the effect of a fine on the **profits available for distribution to partners**, especially the firm's audit partners. In practice, fines are borne by a collection of individuals ie the firm's partners. A fine has a bigger proportional impact on a firm with fewer partners or one whose partners earn less. It is not clear at present whether and, if so, how this factor is currently taken into account in the determination of fines.

Question 4

In imposing sanctions, should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

We think that the answer to this question should depend on the nature of the breach. If an individual has followed the firm's processes, the sanctions should be focused on the firm. If not, they should be more focused on the individual.

The FRC should take into account the impact on individuals when determining the sanctions that it should impose.

When the FRC institutes an investigation, it publicly announces it. Although the FRC does not name Responsible Individuals, they are usually readily identifiable, as they sign audit reports in their own names.

Investigations are immensely trying for individuals. In the past, the effects of investigations by the FRC on individuals have been aggravated by the period of time that it takes to resolve them. Investigations by other professional bodies may take a year or so, whereas the FRC has in the past taken up to eight years. Those people within audit firms who have been involved in such investigations have seen the debilitating effect on the partners involved.

We also propose that the FRC consider the use of private sanctions in the case of minor breaches.

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

One of the FRC's objectives is to increase competition and audit firm rotation amongst the largest listed companies. We believe that the current sanctions regime undermines this objective.

The risks and benefits to many firms of auditing Public Interest Entities are finely balanced. The risks include unlimited civil liability, costs of dealing with civil claims, and reputational damage, in addition to the risks of fines and public censure by the FRC. The benefits include the relevant audit fees, fees for any permitted non-audit work and, to a limited degree, a perception that auditing the Public Interest Entity in question would enhance the firm's credibility with its clientele, or its market presence.

The Grant Thornton UK LLP Transparency Report 2016 discloses at page 43 key information in relation to its performance of statutory audits. These figures include those relating to the statutory audits of public interest entities, which at 30 June 2016 consisted of 55 audits of Public Interest Entities out of 8500 audits in total.

In a recent case, the FRC found that Grant Thornton committed unintentional misconduct in relation to the audit of a public interest entity. The fine from this one case amounted to £2.275 million. This represents nearly 27% of total profit generated from all statutory audits in one year and would represent a much greater proportion of the profit generated from the statutory audits of public interest entities if taken in isolation for that year. In addition, this figure does not include any of the costs of defending the firm's exposure to unlimited liability, as outlined above. If the FRC were to increase its fines, smaller firms would find it harder to justify their presence in this particular market.

The presence of firms in this market is not assured. Firms that are not in this market do not fall within the FRC's purview for such clients, and thereby avoid the fines and reputational harm that would follow. Increasing fines to increase deterrence may have an unintended consequence, it may tip the balance, discouraging firms from competing in this market.

Questions 7 and 8

In relation to fines are they being set at the right level?

No. We feel that the lack of consistency, transparency and proportionality lead to a flawed application of fines as sanctions.

We do not consider it likely that an increase in fines for inadvertent breaches would significantly change behaviour. In this context, it is worth considering the factors that serve to improve audit quality and diminish the likelihood of poor audit work.

Factors that serve as deterrents to poor audit work are:

1. **Civil liability** - For most other work-types, firms limit their liability to either a fixed sum or a multiple of the fee charged, which means that any resulting harm to the firm is confined. Large firms can survive losses at this level, learn from the experience, administer remedial action, and move on.

   For statutory audits, liability is unlimited. All the larger firms commonly face claims in the tens of millions of pounds, and some of them face claims for billions. The legal costs alone of defending such claims are substantial.

2. The **loss of the client**, which usually follows the assertion of a claim.

3. **Reputational harm**, which is incalculable but known to be severe. Clients disengage firms and potential clients reject them because of publicised claims, whether or not the claims are subsequently proven. Regulatory findings too cause firms to lose clients but it is impossible to quantify the resulting detriment.

The financial sanctions that the FRC impose carry serious consequences for the firm yet are less important deterrents than civil liability in respect of poor audits, which poses a catastrophic risk for every audit firm.

We would also note that increasing fines on auditors in cases where there has been fraud or management collusion to misrepresent facts to the auditors implies a wider duty on auditors than an audit is designed to deliver.

Question 9

What are the key elements in achieving effective deterrence?

Public measures of audit quality such as the FRC's published findings of its annual Audit Quality Inspection are the most effective means of increasing the quality of statutory audits. Firms are highly incentivised to improve the quality of their audits by their annual quality gradings. The annual report that contains the FRC's AQR findings assesses the current quality of the firm's work, which gives the market a measure of the quality of the firm's audits.

Audit Committees scrutinise such reports and decide which firms to appoint, or invite to tender, as their auditors accordingly. Poor quality grading cause firms to lose clients and opportunities to tender for new work. Conversely, good audit gradings make it easier for the firm to win new work. Firms pay the utmost attention to the findings in AQR reports and seek to respond quickly to weaknesses that are identified to improve their gradings in the following year.

This point also applies to individuals, whose grading and remuneration is typically determined by taking into account a regulator's quality grading.

Question 10

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

No. The key factor that works against sanctions having the desired impact is the passage of time between the misconduct and the sanctions that follow – up to eight years.

In most such cases, the misconduct in question becomes a matter of historical curiosity because firms are continuously reviewing and developing their practices, procedures and guidance in an attempt to improve the quality of their audits. After 5 or 10 years, a firm's audit practice has therefore moved on and the circumstances that gave rise to the misconduct no longer apply. These changes are not usually prompted by the FRC's investigation but rather the firm's ongoing efforts to improve quality.

A vastly more powerful incentive for firms to improve their audits is the annual report that contains the FRC's AQR findings, in that they assess the firm's work, which gives the market a current measure of its audit quality.

Questions 11 and 13

Should there be greater use of non-financial sanctions such as:
(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or
(b) an order for some form of restitution?

Are there some sanctions which could usefully be imposed which are not currently available?

Yes. We consider that more emphasis should be placed on sanctions which bring improvements in audit quality and corporate governance.

The FRC should consider imposing conditions that training or education be provided in cases where it is not satisfied that the firm has rectified the defects that existed at the time of the breach.

The FRC could also consider requiring a firm to make available the training programmes that it has directed a firm to prepare to its professional body so that it may be used for the benefit of the profession as a whole. This could have a similar financial impact as a fine, as the firm would need to set aside resources, time and money, to develop such training.

We also note that the imposition of time-limited restrictions on undertaking certain types of work could cause the loss of skills, knowledge and experience that may impair the quality of such work in the future.

As to **restitution**, the common law provides remedies to wronged parties and makes wrongdoers make good the losses that they have caused. It is for the Court to decide whether commercial losses have been caused by auditors. We do not believe that this is the function of regulators. The ICAEW refers to restitution but only as a mitigating factor when considering the sanctions for misconduct.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paras. 57-61 of the Accounting Scheme Sanctions Guidance, as does the Sanctions Policy; see paras. 73-77. Are these provisions:
(a) operating satisfactorily; or
(b) inappropriate, and, if so, why?

No. We do not believe that they are operating satisfactorily. We consider that the spectrum of available discounts should be wider and more graduated, and should incentivise firms to engage constructively with the FRC, for example by proactively helping it identify relevant issues.

We suggest that discounts of up to 50% should be available when warranted, which would encourage firms to consider carefully how they could best assist the FRC.

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30 June 2017

Dear Ms Griffiths

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

We welcome the opportunity to respond to the Review Panel's call for submissions in response to the Financial Reporting Counsel's Independent review of Enforcement Procedures Sanctions.

Throughout this response, unless otherwise stated, we refer to the Sanctions Guidance (applicable to matters under the Accountancy Scheme) and the Sanctions Policy (applicable to matters under the Audit Enforcement Procedure ("AEP")) together as the "Sanctions Guidelines".

1. ***Are the objectives set out in the Sanctions Guidance and the Sanctions Policy satisfactory? If not, why not, and how could they be improved?***

   1.1. We are broadly content with the objectives of the Sanctions Guidelines[1], although we suggest that it may be helpful if the objectives were amended expressly to refer to the FRC's objective of improving audit quality. We consider that this may encourage greater consideration of a range of sanctions, including non-financial penalties, which would in

[1] As we have not, as yet, seen any sanctions determined in accordance with the Sanctions Policy under the AEP our comments in this response are based on our experience and observations as to how the Sanctions Guidance has operated to date.

many cases be more effective than financial penalties in achieving the overall aim of improving audit quality.

1.2. As noted below in response to Question 6, we are concerned about the potentially negative impact on the audit profession arising from the recent trend of increasing financial penalties.

2. ***Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances? If not, why not, and how should the Sanctions Guidance/Sanctions Policy be improved? For example, should decision makers be provided with:***

(a) guidance, either of the current or some other type;
(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or
(c) some form of guideline which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.

2.1. We consider that some form of guidance should be provided to decision makers, and subject to the comments below we are broadly content with the current guidelines.

2.2. Amendments and changes which we propose should be made to the current guidelines are:

2.2.1. When determining the sanction to be imposed on a Member, the decision makers should be directed to have regard to the extent to which that Member has already been penalised, or suffered negative consequences as a result of the investigation and subsequent disciplinary process. In our experience, the reality for Members is that as soon as an investigation is announced, even if they are not expressly named, they are likely to begin to suffer a number of negative consequences, in particular:

- The stress and emotional impact of being under investigation, for a prolonged and uncertain period of time, can be very significant, affecting both life at work and outside of work.
- At the request of clients, they may be removed from other audit engagements, and/or not accepted for new audits while the investigation and disciplinary process is ongoing. While each situation is slightly different, a Member's career may already have been very seriously impacted before a tribunal even sits to consider the matter.

2.2.2. We consider it important, just and fair that these matters as well as any other specific individual circumstances are taken into account in determining any sanction. For the avoidance of doubt, we propose that these matters would be considered separately, and in addition to the general consideration of any other personal

mitigating circumstances as already referred to as a mitigating factor in the Sanctions Guidelines.

2.2.3. While not directly relevant to the question of sanctions, we also note that in reality, even if a matter does not progress beyond the investigation stage, because the FRC concludes that there is no basis for disciplinary proceedings, clients may already have been lost and much of the reputational damage for the Member may already have been incurred. This can be particularly unfair given that in many instances the trigger for an investigation will have been an "event" at the client (for example, the discovery of a fraud, a restatement of the financial statements) rather than any particular concern as to the quality of the Member Firm's work, be it an audit or other advice.

2.2.4. The current Sanctions Guidelines indicate that the size and financial resources of a Member Firm should be taken into account when determining the amount of a fine, as should the effect of the fine on its business. In other words, the larger the firm, the larger the fine should be. We do not consider that this should automatically be a significant factor in every case.

2.2.5. We understand the argument that fines should be large enough to have an impact on the Member Firm in question, in order to act as an effective deterrent. Taken too far however, that rationale would mean that the larger Member Firms would need to be fined significant sums of money for even minor breaches of Relevant Requirements under the AEP, whereas a smaller Member Firm found liable for a serious case of Misconduct (under either the AEP or the Accountancy Scheme) would receive a much smaller fine, as a consequence of the relative impact that the fine would have on their respective businesses. In such a scenario financial penalties would cease to reflect the seriousness of the conduct and the breaches in any fair and objective sense, but will be more a reflection of the Member Firm's ability to pay.

2.2.6. The current Sanctions Guidelines also indicate that an aggravating factor when determining the amount of a fine is whether the Member or Member Firm has a poor disciplinary record, including a previous adverse finding from the FRC or other regulator. While we agree that the previous disciplinary record of the Member or Member Firm is relevant, we consider that the Sanctions Guidelines could be amended to make it clearer that a previous fine from the FRC should not automatically be regarded as a significant aggravating factor, and due and careful consideration should be given to the timing, nature and circumstances of the conduct complained of in the previous matter, compared to the current complaint. So, for example, if it can fairly and reasonably be argued that the current complaint shows that a Member Firm has not appropriately responded to the previous adverse finding, then it may be appropriate for a past fine to be regarded as a significant

aggravating factor; on the other hand, the relevance of a past fine is much reduced if related to an issue from many years previous and/or to a very different type of complaint.

2.3. We do not consider that a tariff approach would be suitable or practical, given the very wide range of breaches that the FRC will potentially be dealing with, from matters involving relatively minor, single, one-off breaches of Relevant Requirements, through to the most serious cases, which may involve a number of breaches of Relevant Requirements. Between these two ends of the scale, there will inevitably be a number of different permutations, and producing a tariff which could fit every eventuality would be very difficult. Ultimately, we consider that the appropriate sanction for any given case should be assessed on the specific facts and circumstances of the case.

2.4. For similar reasons, we do not consider that guidelines dividing regulatory breaches into categories, and prescribing a range of penalties for breaches within each category would be appropriate. While it would be helpful to have some degree of certainty as to the range of fines, the wide range of breaches that the FRC may be dealing with means that any attempt to categorise would be very difficult.

3. ***In relation to the matters set out in question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or detailed guidelines would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.***

3.1. As stated above, we do not consider that a tariff or detailed guidelines would be appropriate.

4. ***In imposing sanctions should decision makers seek to place any particular focus on entities rather than individuals or vice versa? In answering this question, respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.***

4.1. We consider that each case should be assessed on its particular facts and circumstances.

4.2. In some instances it may be more appropriate for the sanction to focus on the individual, rather than the Member Firm. This may be the case where, for example, the Member has acted with dishonesty (albeit that we consider that this scenario would be very rare); or has approached the work without appropriate diligence or professionalism; or the area

in which the breach of Relevant Requirement has occurred is an area in which the individual was expected to have direct personal involvement or direct accountability.

4.3. At the other end of the scale, if the conduct complained of is solely (or largely) attributable to a failure of another individual (e.g. a more junior member of the audit team), in an area in which the individual was not expected to have direct personal involvement or accountability, or in the Member Firm's audit procedures, controls or guidance, the focus of the sanction should clearly be on the Member Firm, and in such a situation it may be appropriate for the Member not to receive any sanction.

4.4. In reality, the majority of cases are likely to fall somewhere in the middle of these two examples, and the decision makers should assess all of the relevant facts and circumstances.

4.5. In particular, as we have already commented at paragraph 2.2.1 above, when considering the position of a Member, we consider that it is important to have regard to the extent to which that Member has already suffered, and the impact that the investigation has had, in a financial, professional and personal context.

5. In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities. If respondents think that the FRC should establish some starting point, they are invited to articulate:

(a) how they consider that the starting point should be measured for entities or individuals (e.g. by reference to specific monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);
(b) how the starting point should be determined; and
(c) what criterion/a should produce what starting point(s).

5.1. We do not consider that the FRC should establish a starting point for financial penalties, and again encourage an approach which requires the decision makers to take into account all relevant facts and circumstances, unhindered by reference to starting points and without overreliance on precedents from previous cases. The precedent value of previous Tribunal Decisions and settlements is in our view limited. In particular, the final sanction ordered or agreed in any particular matter will be fact dependent, and the Tribunal Reports or Settlement Agreements often do not contain much detail as to the factors that were taken into consideration in determining the final sanction. The precedent value of previous decisions is in our view even more limited now that the range of matters which the FRC is likely to be dealing with under the AEP will include less serious cases, in respect of which we would expect to see lower fines than those imposed by Tribunals (or agreed as settlements) in recent cases under the Accountancy Scheme.

5.2. In any event, we consider that it would be very difficult to determine an appropriate starting point, or basis for calculating a starting point, not least because of the wide range

and nature of conduct with which the FRC is concerned. We have already indicated above that we do not consider that the size of a Member Firm should automatically be taken into account as a significant factor when determining the sanction to be imposed, and why the rationale of making a fine large enough "to have an impact" is likely to lead to unfair, inconsistent and potentially misleading results. Those same arguments apply to the suggestion of calculating starting points based on factors such as revenue, turnover, audit fee, salary or income.

6. ***To what extent do current sanctions meet regulatory objectives? If they do not, why is that?***

6.1. As noted above in our answer to Question 1, we are broadly content with the Sanctions Guidelines, and the stated objectives of the current sanctions, subject to a small number of comments.

6.2. We do however have some concerns as to the manner in which the Sanctions Guidance has been applied. We have observed, from Tribunal Decisions and settlements over the past few years, that its application has led to a general trend towards financial penalties against Member Firms and Members becoming the expected outcome of the disciplinary process, as well as a general increase in the level of those financial penalties (albeit we recognise that all cases have their individual facts and circumstances).

6.3. We are concerned that this trend arguably appears to be more focused on punishment, than on the objectives of the Sanctions Guidelines, and more widely the FRC's overall regulatory objectives. We note that the Sanctions Guidance does expressly state that "[t]*he primary purpose of imposing sanctions for acts of Misconduct is not to punish, but to protect the public and wider interest.*"

6.4. In particular we are concerned as to:

(a) whether increased financial penalties are in fact likely to be effective in meeting the objectives of the Sanctions Guidelines, and the FRC's overall regulatory objectives of improving audit quality and maintaining public and market confidence in the accountancy profession and the quality of corporate reporting; and

(b) the potential implications for the audit profession as a whole, including the importance of competition and choice for clients, and the ability to attract and retain talent.

The effectiveness of increased financial penalties in meeting the FRC's objectives

6.5. We consider that it is important to consider the nature of the conduct which generally gives rise to FRC enforcement action. In many cases, the breach of Relevant Requirement (or, under the Accountancy Scheme, Misconduct) may be a consequence of an honest and inadvertent error, or the exercise of professional judgement where there

may be no unequivocally "correct" approach. That error, or errors, may of course be a serious error of professional judgement, and may have serious consequences, but what distinguishes the typical auditor misconduct case[2] from, for example, some of the recent misconduct cases which the Financial Conduct Authority ("FCA") has investigated, is that in the latter the conduct in question may involve some deliberate act, or acts, designed to achieve a particular outcome from which the individual or firm may benefit. The element of intent in such situations is generally not present in FRC matters (at least not as far as the Members and Member Firms are concerned). For this reason, we would discourage any suggestion that the large headline fines levied by financial services regulators such as the FCA should be used as a comparator by which to judge the level of FRC fines in situations where there is no suggestion of deliberate misconduct on the part of the Member or the Member Firm.

6.6. Once the inadvertent nature of the conduct which tends to lead to FRC enforcement action is appreciated, the question is whether this is the type of conduct which can be (and is) deterred by the imposition and threat of large financial penalties (which are often imposed several years after the conduct in question has occurred[3]), and also whether large financial penalties in these circumstances are the best option to meet the FRC's other objectives of protecting the public, promoting confidence in the accountancy profession and the quality of corporate reporting, and declaring and upholding proper standards of conduct.

6.7. We accept that financial penalties have a role in encouraging improvements, but we suggest that the focus should be, in the main, on sanctions which help to change and improve behaviours, and to improve the Member Firm's systems, controls and procedures. This would require a shift towards non-financial[4] penalties which require Member Firms, and Members, to invest in positive steps and to take actions which are aimed at improving audit quality, and would, we suggest, be much closer aligned with the objectives of the Sanctions Guidelines and the overall regulatory objectives. For example, we would suggest that public and market confidence is more likely to be improved[5] by publicly announced measures which require a Member Firm actively to work towards improving audit quality (generally or in the specific area(s) of any deficiency), than the imposition of very large fines. Significant fines should not therefore

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[2] The large majority of the FRC's matters relate to audits, and therefore the focus of our response is on audit cases, We do however consider that all of the general principles stated in this response apply equally to all matters within the FRC's jurisdiction.

[3] There are a number reasons why there may be a time lag between the conduct complained of, and the imposition of the sanction, including that given the nature of the events which will often trigger an FRC investigation, for example a corporate collapse or scandal, discovery of the potential issue may not come to light for a number of years. Another reason is, historically the length of the FRC's investigation process, although we note that the FRC now aims to complete all investigations within two years.

[4] There would still be an indirect financial impact on the firm, in the form of the costs of implementing the required actions etc.

[5] One of the objectives of the Sanctions Guidelines.

be seen as a default outcome in every case but be reserved for the more serious cases, especially any involving deliberate misconduct.

6.8. For example, we suggest that the Review Panel may wish to consider the approach of the Health & Safety Executive (HSE) to enforcement and sanctions. The emphasis of enforcement action taken by the HSE is on prevention, and enforcement options/sanctions include providing information and advice, face-to-face or in writing.

Implications for the future of the audit profession

6.9. As the threshold for enforcement action under the AEP is lower than that under the Accountancy Scheme, it is perhaps inevitable that we will see an increase in the frequency of sanctions. If the frequency and level of financial penalties increases, this may impact Member Firms' business and investment decisions. At a time when audit practices are already under profitability pressure from a combination of factors including mandatory rotation of audit firms, and increased requirements for additional work in certain areas (such as the audit of pension fund assets), lowering profitability and heightened risk within the audit business could mean that Member Firms become increasingly more critical in reviewing the type of organisation that they are willing to serve as auditor. Over time, a trend towards reduced risk appetite could potentially be very damaging to audit quality and choice.

6.10. In terms of Members, an important element of the objective of improving audit quality is the ability to attract and retain the brightest and best individuals to the profession, in particular to the roles of engagement partner. We are concerned that an approach to enforcement and sanctions which is perceived as being aimed at punishing individuals for honest, albeit serious, mistakes, risks deterring people from practicing as an auditor and, in particular those people who would best discharge the engagement partner role. This would have a very detrimental impact on audit quality over time.

7. In relation to financial penalties are they being set at the right level? Respondents are invited to state:

(a) whether they think they are too low or too high, and
(b) by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.

7.1. We do not consider that financial penalties are set too low.

8. If respondents think that financial penalties are too low is this because:

(a) failures of the type covered by the procedures require greater censure than is currently given;

(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;
(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;
(d) they do not promote public confidence; or
(e) some other reason?

8.1. We do not consider that the fines imposed are too low. Further, given that the scope of the matters which now fall within the FRC's remit under the AEP will encompass less serious breaches of Relevant Requirements, we would in fact expect to see either lower fines for the less serious breaches and/or a move towards greater use of non-financial sanctions, where these are most likely to achieve the primary objective, namely improvements in audit quality.

9. What are the key elements in achieving effective deterrence?

9.1. In our opinion, there are already a number of factors, only one of which is the threat of a financial penalty, which combine to deter Member Firms and Members from poor conduct, and to encourage high standards. Some of these factors will weigh more heavily on Member Firms than on the Members, and vice versa, but ultimately they will all have some bearing on both.

9.2. In our view the key factors which combine to have a deterrent effect include:

9.2.1. Professional pride, at both an individual and firm level, should not be underestimated. The prospect of an individual's career and established reputation being irrevocably damaged is a highly significant deterrent.

9.2.2. The risk of a claim and the threat of unlimited civil liability arising from negligent work. While the financial risk may lie with the Member Firm, involvement in the litigation process can also have a significant impact on the individual.

9.2.3. Internal reviews of work. A negative internal review can have significant consequences for an individual's career.

9.2.4. External reviews, for example by the AQR. As discussed below, negative AQR reviews are taken very seriously.

9.2.5. An FRC investigation. One aspect of an FRC investigation is the possibility of a financial penalty, but the mere fact of an FRC investigation acts as a deterrent in itself, not least because of the reputational impact, the costs of dealing with the

investigation and subsequent disciplinary process and, the significant personal impact on the individual, as discussed at paragraph 2.2 above.

9.3. As the AQR process demonstrates, a sanction does not need to have a financial impact on a Member Firm in order to be taken seriously, and to be an effective remedy. A negative AQR review has no direct financial impact but is taken very seriously, in particular because it is commenting on the quality of a recent audit, as opposed to an enforcement case which often relates to an audit carried out many years previously. A negative AQR review will have a number of implications, including reputational damage, for both the firm, in particular because the results are communicated to the relevant organisation (and more widely in the form of the AQR's annual reporting), and may also be an area for questioning in pitches for new work, and for the individual, in that an adverse AQR review will be taken into account as part of that individual's review, and may have significant implications for the individual's career. Further, the outcome of an AQR review acts as an effective remedy as it will require a number of steps or actions to be taken in order to rectify weaknesses identified.

9.4. The potential deterrent effect of a financial penalty is also often significantly eroded by the fact that by the time that the financial penalty is imposed (which can, for various reasons, be some years after the event in question took place), accepted standards, behaviours and working practices across the profession may well have changed and improved in any event, as a result of various factors and influences, including changing economic environment, thematic reviews, and other external events. The Member Firm may also have taken steps to improve and provide training in the area which was subject to the complaint and/or requirements may have changed to provide greater clarity on the standard required (which may by itself indicate that the requirements were previously open to different interpretations). The Member in question may also have retired, or ceased practicing for other reasons by the time that the sanction is imposed.

10. Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

10.1. Please see our response to Question 8 above in relation to the risk of focussing on financial sanctions alone. While we accept that financial sanctions have a role to play, we consider that greater emphasis should be placed on non-financial measures which we believe may be more likely to be effective at meeting all of the objectives of the Sanctions Guidelines, at promoting and incentivising good practice and promoting public confidence.

11. Should there be greater use of non-financial sanctions such as:

(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or

(b) an order for some form of restitution?

11.1. We agree that there should be a greater use of non-financial sanctions.

11.2. That said, we do not consider that there is significant scope for restitutionary orders, nor that this would normally be appropriate in the context of a disciplinary process such as this. In particular:

- There is often no clear and definable "victim" or "class of victims" who has suffered an actual loss as a direct consequence of the conduct in question;
- Even if a loss has arguably been suffered, and there is an identifiable victim, it is likely to be very difficult to quantify the amount of loss attributable to the specific breach of Relevant Requirement (as opposed to other errors – for example in the preparation of the financial statements); and
- If actual loss has been suffered by a specific individual(s), the appropriate channel to seek recovery of their losses will be generally be through a civil claim.

12. The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement, as does the Sanctions Policy. Are these provisions:

(a) operating satisfactorily; or
(b) inappropriate, and, if so, why?

12.1. In general, we agree with the inclusion of provision for a discount for admissions and/or settlement subject to two points:

- The Sanctions Guidelines each divide the investigation and disciplinary process into a number of stages, and specify a percentage range for the discount applicable if admissions are made/or a settlement is reached within that stage. For example, under the Sanctions Guidance, stage 1 is from the notice of investigation to delivery of the Formal Complaint, and the discount available is 35% to 20%. We propose that a further breakdown or detail be provided in the Sanctions Guidelines as to how this sliding scale discount range will be applied through each relevant stage.
- In relation to stage 1, in order to encourage the settlement of cases at this early stage, the maximum 35% discount should be available at least until sometime after delivery of the Proposed Formal Complaint ("PFC"), and this should be made clear in the Sanctions Guidelines. As the FRC's process currently operates, the PFC is generally the first time that the Member Firm/Member will see the precise detail of the complaints against it. They cannot realistically be expected to assess whether they wish to enter settlement discussions before they have seen the complaints in the PFC. The alternative would be for the FRC to modify the current process, such

that those under investigation are made aware of the details of the likely allegations against them at a time when the 35% discount is still available.

- We note that this would be consistent with the approach adopted by the FCA. The FCA's maximum discount is available (if everything can be agreed) until after the FCA has provided the respondent with details of its case, the respondent has had a chance to respond, and the FCA has given an indication as to the likely sanction. The respondent in that situation is therefore able to assess the merits of the case against it, before entering settlement discussions.

13. Are there some sanctions which could usefully be imposed which are not currently available?

13.1. We note that the Sanctions Policy which accompanies the AEP does contain some additional sanctions, although we do not yet know the extent to which these will be adopted in practice. In particular, one of the sanctions available is described as an "*order that the Respondent take action to mitigate the effect or prevent the recurrence of the breach of Relevant Requirement.*" It seems to us that this could be interpreted to encompass orders requiring improvements to internal procedures, and remedial measures such as training programmes.

13.2. On the assumption that our interpretation of this sanction is correct, we consider that it should also be made available under the Accountancy Scheme. It may also be helpful to provide further detail as to the type of measures that may come within this sanction. As we have indicated throughout this response, we consider that non-financial sanctions should be considered either as alternatives to financial penalties, or as a part of a "package" of sanctions, focussed on improving behaviours and audit quality. That package of sanctions might in some instances include a financial penalty, albeit at a lower level than current fines, but in our view, non-financial sanctions can, in some instances, be as effective a means of seeking to improve behaviours and audit quality as a financial penalty.

13.3. Should it be considered necessary, the Review Panel may also wish to consider the potential for combining such an order for non-financial sanctions with a financial penalty (perhaps expressed as a deferred fine) if the required procedures, training initiatives (which may, depending on the circumstances, be directed at the Member Firm as a whole, at certain business units, or even at a specific group of individuals) or other directed actions are not put in place or improvements are not observed within a set period of time. Similarly, in respect of training initiatives, it may be appropriate in some

instances to propose that a certain amount of money should be invested in a training programme.

Yours faithfully

KPMG LLP

KPMG LLP

Your reference:
Our reference: 85/350

MOORE STEPHENS

30 June 2017

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Dear Ms. Griffith

INDEPENDENT REVIEW OF THE FINANCIAL REPORTING COUNCIL'S ENFORCEMENT PROCEDURES SANCTIONS

We are pleased to respond to the questions provided by the Independent Review Panel in relation to sanctions.

Our responses to the individual questions asked are attached in an Appendix, but we also have some general comments.

We would note that the current Audit Enforce ment Procedure (AEP) is relatively recent, and there is little experience of its operation in practice. Whilst it is possible to consider the principles of the schemes it is only when there is sufficient experience in practice that it is really possible to determine if the regime is appropriate.

We are concerned that, notwithstanding the statement in the objectives that the purpose is not to punish, that the regime appears to be based primarily on deterrence with the sanctions primarily involving fines of other financial penalties, reprimands and exclusions. There is little mention of constructive remedial action. We accept that the inevitable time delay between an underlying event and a final conclusion that misconduct has been demonstrated means that there are limits to the extent to which remedial action may be judged appropriate, and in particular be publically acceptable. Nonetheless, we feel that a regime that specifically states it is not intended to be punitive can look as though it is precisely that.

We are also concerned that an apparently punitive regime, particularly in relation to the AEP, may act as a deterrent to both individuals and firms entering or remaining with the PIE audit market. The perceived risks of working within this market may be such that individuals with appropriate skills and attitudes will choose alternative areas in which to specialise. Ultimately this will not be for the benefit of the profession or the public. Similarly firms may decide that they wish to leave, or not enter, this market on the basis of the perceived higher level of risk. This could concentrate the market still further.

Should the Panel have any questions in relation to this response or require further information then either David Chopping or Michael Butler would be pleased to assist.

Yours faithfully

Moore Stephens LLP

Moore Stephens LLP

Appendix

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We broadly agree with the objectives taken as a whole.

We are, however, not convinced that for an avowedly non-punitive system it is appropriate that the first objective of the Accountancy Scheme be to "deter members of the profession from committing misconduct" with a similar if differently worded objective for the Audit Enforcement Procedure.

We consider that the third objective is key, with the public protection objective set out in the second bullet points in each case, and the fourth bullet point in each case dealing with maintenance of standards of conduct as secondary objectives. The first is a derived objective.

Question 2

Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

We are not entirely clear about the reference to current circumstances. Given the time inevitably taken in dealing with cases ultimately ending in sanctions, schemes need to be designed to work in different economic environments and circumstances. Schemes which may reflect current political pressures or priorities are unlikely to be properly designed or to cope well when circumstances change.

We do agree that the current, fairly high level, guidance is appropriate and do not agree with the introduction of a tariff based system. Each situation, of the sort of severity that might be covered by these schemes, must be judged by reference to the specific circumstances.

Similarly, a tariff based system is likely to concentrate on financial penalties. As we have noted in our general comments, we consider that such concentration is not appropriate.

Question 3

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

As noted above, we do not agree with a tariff based system.

Question 4

In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

We do not consider that there should be any particular focus on entities or individuals, but that each situation must be looked at entirely on its own merits. There should be no predetermined bias.

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

We do not agree with the establishment of any particular starting point, either in relation to firms or individuals.

The situations likely to be dealt with through the schemes are complex, and judgements need to be made on the particular circumstances.

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

As noted in our general comments we are concerned that there is excessive concentration on financial sanctions.

As noted in our response to question 1 we consider that the key objective of the schemes must be to maintain an appropriate and justified trust in the accounting and audit professions. Sanctions are merely a means to this end.

Taking this together we are concerned that the system as a whole places too much emphasis on financial penalties which are imposed many years after the underlying events. If the public interest is paramount then quicker action which enables changes to be made which are likely to improve quality of financial reporting and auditing should be the priority. The current system has as its first stated objective to deter misconduct but this implicitly assumes that such misconduct is deliberate. Where mistakes, including very serious mistakes, are made penalties will not deter since mistakes are by definition not deliberate. Deterrence can work only for morally culpable behaviour.

Question 7

In relation to financial penalties are they being set at the right level?

There is limited data on which we can respond to this question.

As noted above, our main concern is the concentration on financial sanctions.

Question 8

If respondents think that financial penalties are too low is this because:
(a) failures of the type covered by the procedures require greater censure than is currently given;
(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;
(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;
(d) they do not promote public confidence; or
(e) some other reason?

We do not consider financial penalties are too low.

Question 9

What are the key elements in achieving effective deterrence?

Whilst this question is reasonable in the context of the specific consultation, we do not consider that the objectives of the scheme should be to deter, rather they should focus on enhancing the quality of financial reporting and auditing.

Deterrence is relevant only in relation to deliberate and wilful misconduct. Many cases relate to lack of competence where deterrence is ineffective.

Question 10

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

Whilst sanctions have a role in promoting best practice and public confidence, we believe this is limited.

Question 11

Should there be greater use of non-financial sanctions such as:
(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training
and/or
(b) an order for some form of restitution?

We support such an approach. However, this has to be based on measures that are most likely to lead to improvement in quality.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:
(a) operating satisfactorily;
or
(b) inappropriate, and, if so, why?

We do not have experience of this in operation in order to be able to comment.

Question 13

Are there some sanctions which could usefully be imposed which are not currently available?

We consider that the sanctions currently available are appropriate, but that in practice it appears the full range of sanctions are not sufficiently used.

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Ms Noranne Griffith
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By email to: enforcementproceduressanctionsreview@frc.org.uk

28 June 2017

Dear Ms Griffith,

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

I write in my capacity as Chairman of PricewaterhouseCoopers LLP's (PwC) Public Interest Body (PIB), and on behalf of the five independent non-executive members appointed to the PIB. By way of background, membership and activities of the independent non-executive members reflect the objectives of the Audit Firm Governance Code, which state that audit firms should appoint independent non-executives to improve confidence in the public interest aspects of the firm's decision-making, dealing with stakeholders and management of reputational risks. In addition to the independent non-executives, the PIB's members comprise executive management and representatives from the PwC partners' Supervisory Board. Our agenda focuses on those issues which are most relevant to the public interest.

It is clear to us that both the delivery of the statutory audit, and the existence of a thriving audit profession, are matters of the highest public interest. The statutory audit plays a critical role in providing assurance to shareholders that the directors of a company have presented a reliable, robust and objective view of the company's financial position. As such, an audit underpins the trust and obligation of stewardship between those who manage a company, and those who own or invest in it. The statutory audit in the UK also enhances stakeholder trust in corporate reporting, which is an essential feature of the UK's capital markets, and has established the UK as a leader in the audit profession.

We support the use of sanctions by regulators of the accountancy profession (e.g. the FRC and the professional bodies), and we understand that sanctions are an essential component of any regulatory regime. We agree with the objectives underpinning the Sanctions Guidance for the Accountancy and Actuarial Schemes, and the Sanctions Policy for the Audit Enforcement Procedure.

Our view, as regards the review of the FRC's sanctions under its enforcement procedures, is that the panel should not seek to increase penalties beyond those which are currently available. To do so could lead to negative consequences, including causing damage in a number of areas, as set out below.

1. Damage to public confidence in audit - the statutory audit provides a system for the auditor, as an independent professional, to give an informed opinion on whether a company's financial information, as presented in its annual report, gives a true and fair view of the financial performance and position of the entity. The delivery of statutory audits is a matter of the highest public interest but changes to sanctions, including increases in financial penalties, are likely to drive negative publicity and adverse headlines about audit firms and individual auditors. It is inevitable that these will, in turn, undermine public confidence in audit as a

whole.

2. Restriction on competition and choice in the audit market for public interest entities - a thriving audit profession requires competition between audit firms, and choice for customers in the audit market. These in turn drive up standards of quality, including the increasing introduction of technology into audit methodology, and encourage lower prices. The audit profession creates jobs and opportunities for graduates and school leavers, whilst also providing a valuable professional training. This could be threatened if audit firms were to be exposed to increased risk - both financial and reputational - as a consequence of greater sanctions. The risk of unlimited liability for audit in the context of civil litigation (and the price of mitigating it) is already a material cost of doing business for audit firms, as is the internal investment which is required in order to maintain audit quality. We are concerned that increased financial penalties, coupled with the damage to reputation which follows the announcement of an FRC investigation, could drive firms away from the audit market for public interest entities, leading to reduced competition and choice in a market which is already limited.

3. Damage to accountancy as a profession and a career choice - a continued focus on the investigation of individuals, and the consequent imposition of sanctions, could result in the audit profession being less attractive as a career choice. Maintaining the attractiveness of the profession is important because the audit firms, in particular the larger firms, train and develop significant numbers of school leavers and graduates, many of whom go on to become future business leaders. If applications for training contracts were to decrease due to a perception that the profession is not an attractive career choice, this would have implications not only for audit firms but also for the wider business economy.

4. Impact on audit quality - as PIB members, we know the emphasis which PwC's leadership has placed on improving audit quality. This is borne out by the results of the inspections by the Audit Quality Review (AQR) team at the FRC for 2016/17 which show that 93% of PwC's audits were assessed within the top category of "Good with limited improvements required". Another focus for PwC in the context of audit quality is the use of technology in audit. We understand that PwC in the UK, and the PwC network, have invested heavily in recent years in the innovative use of technology. An increase in penalties beyond those under the current regime could make the audit business less attractive as an investment proposition than other disciplines within a professional services firm. In turn, this could drive a reluctance to commit further investment in audit technology which could have a detrimental impact on audit quality.

Under the current regime, the combination of significant financial penalties for both audit firms and individual auditors leads to a lengthy disciplinary process. Increased fines and sanctions will inevitably extend that further. Delays in the investigation process, coupled with the fact that the issues under investigation remain open until conclusion, mean that lessons which could be learnt are deferred for long periods. This does not enhance audit quality.

We recommend a more collaborative approach to enforcement in which audit firms would be encouraged to make admissions and to enter in to settlement discussions at an early stage. Such an approach might include identification of lessons to be learnt by the audit firm, a requirement for the firm to communicate key learnings internally and a commitment to take follow up action, such as provision of training to all audit staff, with ongoing monitoring if necessary. A collaborative approach would lead to swift decisions and enable prompt publication of outcomes, resulting in enhanced audit quality and improved public trust in audit.

We look forward to the report from the independent panel following the conclusion of the review. If the members of the panel would find it helpful to discuss the above, we would be happy to meet or to discuss over the telephone.

Yours sincerely,

Lord O'Donnell
Chairman of the Public Interest Body

for and on behalf of the independent non-executive members of the Public Interest Body:
Lord O'Donnell
Dame Helen Alexander
Sir Ian Gibson
Mr Justin King CBE
Mr Paul Skinner CBE

pwc

Noranne Griffith
Secretary to the Review Panel (Enforcement Procedures Sanctions)
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By email to: enforcementproceduressanctionsreview@frc.org.uk

28 June 2017

Dear Ms Griffith,

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

PricewaterhouseCoopers LLP (We) welcome the Review Panel's call for evidence and are pleased to have the opportunity to respond.

The large multi-disciplinary professional services firms make a significant contribution to the UK economy and to society: they are large scale employers, provide comprehensive training to their people (many of whom go on to work in other areas), and contribute through the taxes arising from their businesses. At PwC we have measured our total impact (economic, tax, social and environmental) in 2016 as $4.55bn and our total tax impact for the same year as £1.760m[1]. We make choices as to where to invest to secure the long term sustainable future of the business, and have invested heavily in the technology systems which support the audit[2]. We will continue to work hard to reduce the possibility of audit failure to as low a level as possible.

We are strongly supportive of the FRC's priorities for 2017-18, including promoting justifiable confidence in audit. In our consideration of how the FRC's sanctions regimes might be made most effective, we have held this objective, and that of improving audit quality, uppermost. We have also considered how the sanctions regimes will operate in conjunction with other parts of the system in place to promote and improve audit quality. We believe that specific consideration of these two elements of context will help to mitigate the risk of unintended consequences of any changes to the sanctions regimes. For example, increases in financial penalties could damage the public perception of the audit profession, with negative implications for audit firms, individual auditors, and for the FRC's overall objective of promoting justifiable confidence in audit. Any such change, therefore, should be considered in the context of the audit quality system as a whole.

Auditing is an activity that relies heavily on individual professional judgement, and this means that a zero failure rate is likely to be unachievable. We are also mindful of the risk that ever increasing punitive sanctions could create the impression that there is a degree of wrongdoing, or "iniquity", associated with audit failures. The reality, in most cases of audit failure, is that professional auditors, acting in real time situations, may have made flawed judgements, alongside failures on the part of company management. The FRC has emphasised the importance of root cause analysis on the part of audit firms to identify the underlying causes of such judgement failures, and we agree that investment in this activity is essential.

In this covering letter we have set out our main observations on the points raised in the call for evidence (points 1-3 below) and some additional points (points 4-6 below).

We attach three appendices as follows.

- Appendix I - our responses to the questions in the call for evidence. These focus on the Sanctions Policy under the Audit Enforcement Procedure (Sanctions Policy) and the Sanctions Guidance under the

[1] http://www.pwc.co.uk/who-we-are/annual-report/annual-report-corporate-impact/annual-report-2016--timm-wheel.html

[2] https://www.pwc.co.uk/annualreport/assets/2016/pdf/annual-report-2016-transparency-report.pdf

Accountancy Scheme (Sanctions Guidance); we have no experience of investigations under the Actuarial Scheme.

- Appendix II - an overview of the Institute of Chartered Accountants in England and Wales (ICAEW) and Financial Conduct Authority (FCA) procedures for determining financial sanctions, to which we refer in our responses.
- Appendix III - a summary of our investment in, and record on, audit quality.

Main observations on the points raised in the call for evidence

1. **The objective to deter (Questions 1, 6, 9)**

We agree with the objectives in the Sanctions Policy and Sanctions Guidance which include the intention to deter. We understand the importance of the intended deterrent effect in some cases, and we appreciate that all sanctions regimes must have some element of deterrent as a disincentive to the most egregious cases of misconduct (under the Accountancy Scheme), and breaches of "Relevant Requirements" (under the Audit Enforcement Procedure).

However, where the underlying cause of an audit failure is unintentional, we do not believe that the deterrent effect is relevant, and consider that the other objectives are much more important. In our experience of audit investigations by the FRC under the Accountancy Scheme, where audit work has been found to fall significantly short of the standard reasonably to be expected, the underlying causes have typically been unintentional failures in the exercise of audit judgement, rather than conduct which is dishonest or lacks integrity. In order to respond appropriately to such cases in the future, we suggest the Review Panel considers introducing a step change between the level of sanctions imposed for genuine mistakes (where there is no need for a deterrent effect and there is no evidence to suggest that deterrence will be effective), and the level of sanctions imposed for those rare matters that involve intentional, dishonest, deliberate or reckless behaviour (where there is clearly a need for deterrence).

We also note that the Sanctions Policy and Sanctions Guidance already incorporate a considerable deterrent for audit firms/individuals in the form of significant damage to reputation as a consequence of an FRC investigation (which can take years)[3]; this is the case whatever the underlying cause of the issue. There is also the potential for damages in the event of civil litigation, and the threat of unlimited liability for the auditor who is required to sign the audit opinion in his or her own name, for and on behalf of the audit firm[4].

We have set out more detail on these points in our responses to Questions 1, 6 and 9 at Appendix I.

2. **Sanctions Guidance/Sanctions Policy fit for purpose (Question 2)**

In our view the Sanctions Policy and Sanctions Guidance are broadly fit for purpose. We suggest that they could be further improved by including a clearly articulated rationale for the award of financial (and other) sanctions to ensure that they are proportionate, consistent and understood.

In particular, we recommend that the Review Panel introduce a starting point for penalties in respect of different breaches or types of misconduct. The Institute of Chartered Accountants in England and Wales (ICAEW) Guidance on Sanctions, and the Financial Conduct Authority (FCA) enforcement scheme, include starting points and have a structured approach to determination of sanctions. This gives flexibility for decision makers to adjust sanctions, depending on the facts of each case, whilst also

[3] The FRC's investigation into PwC's role as auditor of Tesco Plc was announced in December 2014 and closed more than two years later in June 2017 when the FRC concluded there was no prospect of an adverse finding against PwC

[4] s.503 Companies Act 2006. Although it is possible for statutory auditors to limit their liability by contract (s.534 Companies Act 2006), in practice audit clients do not accept limitation of liability by auditors

ensuring that sanctions are objective, demonstrably proportionate and based on a clear rationale. We have set out further detail in our answer to Question 2 at Appendix I, and in Appendix II.

3. **Decision makers to focus on entities rather than individuals when imposing sanctions, or vice versa? (Question 4)**

We suggest that the decision maker should retain the discretion to focus on either entities, or on individuals, or on both, depending on the facts and circumstances of each case. In particular, in cases where there is dishonesty or lack of integrity on the part of an individual, we agree that the focus should be on the individual, with the appropriate sanction being exclusion where dishonesty is proved.

However, in our experience, these cases will be rare. It is more likely that cases will involve errors of judgement, which do not involve dishonesty or a lack of integrity on the part of an individual. In these cases, we suggest that it would be more appropriate for the decision maker to focus on the entity when imposing sanctions. Through sanctioning the entity, due focus will be brought to the need for the entity to investigate the root cause of the failure in judgement, and to remediate that root cause appropriately. A sanction on an individual would not achieve this aim.

We note also that for an individual auditor who has any involvement with an FRC investigation there will be a considerable emotional strain, the potential for damage to reputation, increasing demands on their time (to prepare a defence to the investigation) and possible internal action by the audit firm. The potential for damage to reputation is significant because as soon as the FRC announces an investigation into a firm and an audit client, the individual auditor's name can be deduced, and the subsequent investigation can be lengthy. This is in contrast to publication of investigations by the FCA and the ICAEW which is not usually made until after the investigation is substantially complete.

These pressures would be relieved in part by the FRC proceeding against the entity rather than the individual, unless there is a specific reason to do so (as we have set out above). In our view, if in such cases the FRC chose to proceed against the entity and not the individual, the rights of the individual would be better balanced with the public interest. We have set out further detail in our answer to Question 4 at Appendix I.

4. **Greater use of non-financial sanctions (Question 11)**

We suggest that FRC tribunals and decision-makers should consider making greater use of non-financial sanctions, such as undertakings to provide mandatory training to audit partners and staff. In this way, lessons learned from investigations may be quickly and effectively communicated to audit firm partners and staff and the delays associated with the current enforcement procedures avoided. The Accountancy Scheme and the Audit Enforcement Procedure both include a range of non-financial sanctions which may be imposed either on their own or in combination with other sanctions. A collaborative approach to enforcement which focuses on improvement, positive outcomes and prompt resolution of issues would be more effective than the current regime, which is focused on deterring deliberate poor behaviour, as it would build public confidence in audit and improve audit quality.

5. **Discount for admissions and/or settlement (Question 12)**

We support the objectives of the FRC's arrangements for admissions and/or settlement. However, in our experience, the current operation of these arrangements does not yet enable meaningful two way discussions with the FRC and, therefore, does not incentivise admissions and/or settlement.

In particular, it is important that the FRC is able to engage in open and constructive discussions on settlement and that discounts for admissions can be applied which will help achieve a speedy and effective enforcement outcome.

We recommend that the Review Panel considers the practical operation of the FCA's early settlement procedures as a useful comparator. Here, the FCA creates an early settlement dynamic by indicating the

areas that the party is requested to admit to, and the penalty that is sought. Agreement triggers the first and largest discount to the penalty available under the early settlement scheme. We have set out further detail on this area in our answer to Question 12 at Appendix I.

Additional points - We have the following additional points.

6. **Promoting confidence in audit and audit quality**

We support the FRC's priorities for 2017-18 which include promoting justifiable confidence in audit[5]. For audit firms, the provision of high quality audit services is a strategic and competitive imperative. From the FRC's own work and published reports it is clear that audit quality is improving. The recently published results[6] of the 2016/17 FRC audit quality inspections show an improving trend, with 81% of FTSE 350 audits categorised as requiring no more than limited improvements. This compares to 77% in 2015/16 and 70% in 2014/15. The latest available results from the FRC's annual survey of Audit Committee Chairs (2016) also show an improving trend in views of the overall quality of audit firms (89% in 2016 vs 84% in 2015)[7].

In our view, this demonstrable improvement in audit quality has been driven by two factors:

- the sustained emphasis on audit quality by audit firms over many years; and
- the positioning of the FRC as an improvement regulator, working collaboratively with the audit firms to identify areas of focus.

We do not believe that the improvement is associated with the relatively small number of sanctions imposed on those occasions when audit work has been found to have fallen significantly short of the standard reasonably to be expected.

In order to sustain and accelerate further improvement in audit quality, therefore, we suggest that the FRC should continue to embed a culture of improvement in its supervision and enforcement practices.

We have set out further detail in Appendix III on how we invest in audit quality, our record on audit quality and the relatively small number of audits which have been the subject of FRC enforcement procedures.

7. **Unintended consequences**

A vibrant and competitive audit market with a wide choice of audit firms is fundamentally important to the future of audit, to the success of the FRC's mission *"to promote high quality corporate governance and reporting to foster investment"*[8] and to the wider economy.

An enforcement regime which is overly punitive could have the unintended consequence of having a negative impact on competition and choice in the audit market, and could damage the attractiveness of accountancy as a career choice. We believe that a regime combining higher financial penalties with a focus on investigation of individuals and a highly critical tone would be likely to trigger these consequences. We recommend, therefore, that this review should consider the operation of sanctions within the wider context of the audit market and the culture of the accounting and auditing profession.

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[5] https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Plan-Budget-and-Levies-2017-18.pdf

[6] https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/June/FTSE-350-audits-improved-with-further-action-neede.aspx

[7] https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Developments-in-Audit-%E2%80%93-February-2017-update.pdf

[8] https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-s-Strategy-for-2016-19.pdf

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In our view, the FRC's current narrative on enforcement and sanctions, including its press releases on investigations, could be better balanced with constructive discussion of what went wrong and suggestions for future improvement. This would also be more aligned with the FRC's stated aspiration to be a collaborative regulator with a focus on improvement.

8. **Post implementation review**

We recommend a review of any revised sanctions procedure to ensure that it is operating effectively and meeting the stated objectives. We also suggest that the FRC consider introducing indicators to track progress and performance in the area of professional discipline (a point which we have already made to the FRC in our response to its consultation on the Audit Enforcement Procedure)[9].

We would welcome the opportunity to discuss these points with you. If that would be helpful and/or if you have any other questions, please contact Margaret Cole, General Counsel and Chief Risk Officer (0207 212 2016).

Yours faithfully,

PricewaterhouseCoopers LLP

[9] PwC's letter to the FRC dated 4 May 2016

APPENDIX I

INDEPENDENT REVIEW OF FRC's SANCTIONS UNDER ENFORCEMENT PROCEDURES RESPONSES TO QUESTIONS

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

[The objectives set out in paragraph 9 of the Sanctions Guidance for the Accountancy Scheme (which are the same in the Actuarial Scheme Sanctions Guidance) are set out in Appendix 2. The objectives of the Audit Enforcement Procedure specifically in relation to sanctions are encapsulated in paragraphs 11 and 12 of the Sanctions Policy (Audit Enforcement Procedure) which are, also, set out in Appendix 2.]

We agree with the objectives in the Sanctions Guidance for the Accountancy and Actuarial Schemes (Sanctions Guidance), and Sanctions Policy (Audit Enforcement Procedure) (Sanctions Policy). In particular, we agree with both the Sanctions Guidance and the Sanctions Policy that the primary purpose of imposing sanctions is to protect the public interest, rather than to act as a punishment.

The intended deterrent effect is important, both to promote public confidence and uphold standards of conduct, and it is vital to deter the most egregious cases of behaviour. In particular, the Sanctions Policy reflects the spirit of the EU Audit Directive 2014/56, which highlights the importance of the deterrent effect of sanctions, in particular in paragraphs 1 and 16 of the recital which state:

"*....in order to reinforce investor protection, it is important to strengthen public oversight of statutory auditors and audit firms by enhancing the independence of Union public oversight authorities and conferring on them adequate powers, including investigative powers and the power to impose sanctions, with a view to detecting, deterring and preventing infringements of the applicable rules in the context of the provision by statutory auditors and audit firms of auditing services*";

and

"*Competent authorities should be able to impose administrative pecuniary sanctions that have a real deterrent effect... other types of sanctions which have a suitable deterrent effect should be envisaged.* "

The Audit Enforcement Procedure, and both the Accounting and Actuarial Schemes already incorporate deterrents for audit firms and individuals in the form of significant damage to reputation as a consequence of an FRC investigation, which can take as long as seven years between the announcement of the investigation and the decision of the tribunal. There is also the potential for damages in the event of civil litigation and the threat of unlimited liability for the auditor who is required to sign the audit opinion in his or her own name, for and on behalf of the audit firm (s. 503 Companies Act 2006)[10].

The Sanctions Policy applies where there has been a breach of "Relevant Requirements" (i.e rules or regulations), whereas the Sanctions Guidance applies in cases where a member or member firm has committed "misconduct", where misconduct covers a range of behaviours from dishonesty to lack of integrity and simple mistakes. We note that, as yet, no sanctions have been imposed under the Audit Enforcement Procedure.

So far as we are aware, in all audit cases, sanctions under the Accountancy Scheme have been imposed for actions which have not been deliberate; rather the actions which have given rise to sanctions have been a consequence of audit judgements which have, unintentionally, fallen significantly short of the standard reasonably expected. In

[10] Although it is possible for statutory auditors to limit their liability by contract (s534 Companies Act 2006), in practice audit clients do not accept limitation of liability by auditors.

our view the deterrent effect of sanctions is not relevant in cases where actions have not been deliberate. As a result, we suggest that consideration is given to introducing a step change between sanctions for genuine mistakes (such as errors of professional judgement) and sanctions for matters that involve dishonesty or a lack of integrity. In addition, there is also a need to draw a distinction between the aim of deterring an individual from acting dishonestly or without integrity, and the aim of improving audit quality and helping individuals to make better audit judgements.

Question 2

Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:
(a) guidance, either of the current or some other type;
(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or
(c) some form of guideline which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.

(a) Should guidance be provided?

In our opinion, both the Sanctions Guidance and the Sanctions Policy are not fit for purpose, and require amendment to ensure that the financial (and other) sanctions are proportionate and consistent and are based on a clearly articulated rationale. We appreciate the need for separate investigation and sanction regimes focusing respectively on misconduct and breach of "Relevant Requirements"'. However, we wonder whether there could be a greater consistency of approach between the Accountancy and Actuarial Schemes and the Audit Enforcement Procedure, although consistency with respect to the quantum of sanctions would not be appropriate.

Whilst there may be policy reasons (for example, relating to the types of behaviours they are designed to address) why it is not appropriate to align the approach to Sanctions Guidance (both sets) and the Sanctions Policy, in our opinion it would be helpful for users of the guidance (whether tribunal members, decision-makers, audit firms or individuals) if the text of the three documents could reflect each other as far as possible.

We have identified the following points which, in our opinion, should be reflected in the Sanctions Guidance for both the Accountancy and Actuarial Schemes, and the Sanctions Policy.

- Sanctions imposed by another regulator - there is a difference between the Sanctions Policy (para 23) and Sanctions Guidance (para 20 for both the Accountancy and the Actuarial Schemes). Under the Sanctions Policy, the decision-maker is to have regard to whether sanctions have been or may be imposed by another regulator or other authority in respect of the breach, but under the Sanctions Guidance a tribunal is to disregard whether sanctions have been or may be imposed by another regulator or authority. We suggest that, unless there is a policy reason to the contrary, the Sanctions Guidance is amended to reflect the Sanctions Policy on this point, to avoid potential "double jeopardy" where a double sanction is unwarranted.

- Exclusion for limited period - a prohibition from carrying out statutory audit can be imposed on the statutory auditor/audit firm for a period of up to three years under the Sanctions Policy (para 55) but for an unlimited period under the Sanctions Guidance to the Accountancy Scheme (the title above para 44 refers to "a recommended period of time"). We suggest that the Sanctions Guidance is amended to reflect the Sanctions Policy on this point.

- Factors to consider when assessing potential sanctions - in the interests of consistency the list of factors to be considered by decision-makers when assessing potential sanctions should, where appropriate, be

the same. These factors are in para 21 Sanctions Policy, para 18 in both sets of Sanctions Guidance, and are different. In particular, sub-paras (e) and (f) of para 21 Sanctions Policy (which relate to the financial strength and level of cooperation of the statutory auditor or statutory audit firm) are not listed as factors to consider in the Sanctions Guidance, although financial resources (whether for a Member of a Member Firm) is reflected in paras 32 - 34 of the Accountancy Sanctions Guidance and para 34 of the Actuarial Scheme Sanctions Guidance. We cannot see any policy reason why the level of co-operation of the statutory auditor should not also be applicable to the Accountancy and Actuarial Schemes.

- Early resolution - there is a difference in percentage reductions which are available for early resolution in the Sanctions Policy at para 76 and Sanctions Guidance (Accountancy Scheme at para 59/Actuarial Scheme at para 61). We suggest that these are made consistent (see our answer to Question 12 below).

(b) and (c) Tariffs, categories and associated penalties

We do not support the use of tariffs as, in our opinion, they do not provide sufficient flexibility for FRC decision-makers/tribunals when considering sanctions. Additionally, a tariff could be seen to impose a "going rate" for misconduct or breaches of 'Relevant Requirements', which may be less acceptable from a public interest perspective. However, we would recommend that consideration be given to including in the Sanctions Guidance and Sanctions Policy a starting point for different breaches or types of misconduct.

The Institute of Chartered Accountants in England and Wales (ICAEW) Guidance on Sanctions[11] (the Guidance) provides comprehensive guidance on sanctions for members of the ICAEW conduct and regulatory committees. This Guidance enables committee members to take a structured approach to imposing sanctions. The Guidance gives a suggested "starting point" for each type of complaint, and makes it clear that this is "... *not 'the going rate' for that particular complaint*" (i.e.a tariff). Once a committee has identified the "appropriate starting point" for the issue under consideration, any specific facts of the case, including aggravating and mitigating factors, can be taken into consideration (and examples are given in the Guidance), giving the committee the flexibility to increase or decrease the penalty as appropriate.

The Financial Conduct Authority (FCA) enforcement scheme has a similar approach which sets out both a starting point and a clearly defined process to be followed when determining financial sanctions. The FCA scheme requires a starting point to be established and then adjusted according to the seriousness of the conduct, as well as for aggravating and mitigating factors.

In our opinion, a clear starting point and a structured approach gives the flexibility to adjust sanctions depending on the facts of each case, without limiting the tribunal/decision-makers' discretion, but ensuring that sanctions are objective, demonstrably proportionate, as well as ensuring that the rationale behind a sanction can be clearly articulated.

Further details of the ICAEW and FCA sanctions procedures are included in Appendix II.

We would welcome clarity over how past sanctions are treated under both the Accountancy Scheme and the Audit Enforcement Procedure, as this is not covered in either the Sanctions Guidance or the Sanctions Policy. In our opinion, past sanctions against a firm should be considered in relation to a new investigation, only where they provide credible evidence that a firm's failings are pervasive, and, as an audit firm may carry out a significant number of audits each year, it is unlikely that one case alone will indicate a pervasive problem (see also point 3 at Appendix III). Furthermore, we suggest that past sanctions should be ignored after a period of time, in a similar way to other regimes, for example criminal convictions which are ignored under the Rehabilitation of Offenders Act 1974. This would ensure that historic sanctions, that do not provide evidence of pervasive failings, are not taken into account in later investigations, effectively as an aggravating factor.

[11] https://www.icaew.com/-/media/corporate/files/about-icaew/what-we-do/protecting-the-public/complaints-process/guidance-on-sanctions.ashx

Question 3

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

As explained in our response to Question 2, we suggest that consideration should be given to including in the Sanctions Guidance and Sanctions Policy a clear starting point for different instances of misconduct or breaches of "Relevant Requirements", as well as specific aggravating and mitigating factors for different complaints to be considered. This would be consistent with the approach of a starting point and a defined process adopted by both the ICAEW and the FCA (see Appendix II), and would give confidence that financial sanctions were being determined on an appropriate and proportionate basis.

Question 4

In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?
In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

Whether a decision-maker should focus on entities rather than individuals will depend on the facts and circumstances of each case. However, in cases where there is dishonesty or lack of integrity on the part of an individual, which will be determined as part of the investigation, it is correct that the focus should be on the individual, with the appropriate sanction being exclusion where dishonesty is proved. However, those cases will be rare. In cases of errors of judgement, which do not involve dishonesty or lack of integrity, we do not consider it necessary for the fulfilment of the FRC's priorities for there to be separate sanctions against individuals.

When the FRC announces an investigation into a firm there will be an impact on the individual member involved, especially as their name can be deduced from the name of the firm and the audit client. For an individual, especially one whose conduct falls significantly short of dishonesty or lack of integrity (i.e. who has made an honest mistake), the impact can be significant, as follows.

- The stress and emotional impact of being subject to an FRC investigation - this can be significant and disproportionate to the underlying conduct, whether or not the investigation results in sanctions being imposed on the individual personally.
- The likelihood of damage to an individual's personal and professional reputation, and potential damage to their future career.
- Internal action taken on the part of the firm in cases where the individual is found to be at fault.
- The threat of unlimited liability from civil litigation for the auditor who, by virtue of s.503 Companies Act 2006, is required to sign audit opinions in his or her own name, for and on behalf of the audit firm[12].

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?
If respondents think that the FRC should establish some starting point, they are invited to articulate;
(a) how they consider that starting point should be measured for entities or individuals (e.g. by reference to specified monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);

[12] Whilst it is possible for statutory auditors to limit their liability by contract (s534 Companies Act 2006), in practice audit clients do not accept limitation of liability by auditors.

(b) how the starting point should be determined; and
(c) what criterion/a should produce what starting point(s).

In the interests of having sanctions that are demonstrably proportionate and transparent, as well as ensuring that there is a clear articulated rationale underpinning sanctions, we recommend that consideration is given to a system of starting points for financial sanctions, which can be increased or decreased as appropriate, rather than a fixed tariff approach (see our response to Question 2 above). Such a system would also ensure consistency of approach and transparency by FRC decision-makers and tribunals, as well as giving the flexibility to adjust sanctions depending on the specific facts of each case which is, in our opinion, critical.

Financial sanctions on firms
The operation of the procedure for sanctions (and in particular financial sanctions) followed by the ICAEW and the FCA is set out in Appendix II. Both bodies have a clear starting point for financial sanctions, which in the case of the FCA is equivalent to a "disgorgement plus" system (this is also the approach adopted by the ICAEW in certain circumstances).

In our opinion, adopting a more structured approach to sanctions, similar to the FCA or ICAEW models, would ensure that sanctions imposed by the FRC were proportionate, understandable rather than arbitrary, and consistent, whilst giving the decision-maker or tribunal the flexibility to adjust the sanction depending on the facts of each case.

A system based on disgorgement would, we suggest, be appropriate for audit firms, to ensure that sanctions are proportionate. On this basis, we suggest that the starting point could be based on the amount of revenue generated by the particular assignment under investigation (for example, the audit fees earned) rather than the revenue of the entire audit firm or relevant business unit. This model would follow that of the FCA and, for some complaints, the ICAEW, as well as the Public Company Accounting Oversight Board (PCAOB) in the US.

We note that paragraph 33 of the Sanctions Guidance, and para 45 of the Sanctions Policy, refer to the "*amount of revenue generated by the firm or the business unit(s) involved ...*". However, in practice, firms will vary as to whether audit is a stand-alone business unit. For example, in the UK PwC's "Assurance" line of service includes not only the results of audit, but also the results of risk assurance and actuarial services[13], in addition to the results of PwC's subsidiary in the Middle East. This approach may, therefore, lead to a lack of comparability, and be totally disproportionate where none of the other client assignments, teams or people are in any way at fault. It is for this reason that, in our opinion, the amount of revenue generated by a particular assignment is the appropriate starting point for sanctions.

Financial sanctions for individuals
For individuals, the current guidance indicates that consideration is taken of the financial resources and annual income of the individual, as well as the effect of a financial penalty on the member and his future employment (see para 32 (iii) of the Sanctions Guidance and para 44(d) of the Sanctions Policy). In our opinion, a reasonable starting point for an individual would be an appropriate percentage of annual income alone (i.e. their remuneration for, but not directly related to, the work under investigation).

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

The Sanctions Guidance includes deterrence as a key objective "*to deter members of the accountancy profession from committing 'Misconduct'*". The Sanctions Policy has a similar objective: "*to deter Statutory Auditors from breaching the Relevant Requirements relating to statutory audit*". In our view, the current sanctions regime

[13] PwC's Transparency Report explains that "audit" includes audit and capital markets, regulatory and other similar assurance: statutory and non-statutory audit, financial accounting, corporate reporting, compliance with new and existing regulations and remediation, risk and regulatory monitoring, International Financial Reporting Standards (IFRS) and new UK GAAP conversions, assurance on capital market transactions and listings and assurance on non-financial information.

already incorporates deterrents for audit firms/individuals (as we have explained in our response to Question 1 above).

We have the following comments to make in relation to the regulatory objectives.

1. **Primary purpose of imposing sanctions is not to punish** - the regulatory objectives of the Sanctions Policy and Sanctions Guidance provide that the primary purpose of imposing sanctions is "*not to punish but to protect the public and the wider public interest.*" However, FRC investigations are lengthy, and protracted investigations lasting several years, run contrary to this purpose, as the delay punishes rather than protects (in terms of impact on reputation, as well as the emotional toll on individuals). The length of FRC investigations is a point which we bring out in training of our audit partners and staff, and that in itself is a deterrent. Additionally, if financial sanctions increase year on year, the distinction between deterrence and punishment may well become indistinguishable.

2. **Maintain and promote public and market confidence** - the Sanctions Guidance/Sanctions Policy include the regulatory objective to: "*maintain and promote public and market confidence*". In order to meet this objective, the FRC should establish some indicators to track its progress and performance in the area of professional discipline. A formal time limit on investigations could be considered giving a key performance indicator against which the FRC can be measured. Furthermore, if the FRC's narrative on sanctions was better balanced, and included a discussion of good practice, this would, in our opinion, contribute to maintaining and promoting confidence in audit.

3. **The objective to deter** - The damage to reputation is the most significant deterrent factor in an FRC investigation, and when the level of sanctions are determined, the damage already incurred should be taken into account . However, in our opinion, the deterrence is only effective to prevent an individual from committing a deliberate act, and we are not aware of any evidence that indicates that deterrence is effective in regulation. Judgement pervades the audit and, in practice, the majority of cases deal with honest mistakes or errors of judgement, and we question whether deterrence leads to improved audit quality. Indeed, it is important to ensure that the deterrent characteristics of the regime do not undermine the overall, systemic, objective of improving audit quality.

4. **Other financial deterrents** - The threat of unlimited liability from civil litigation for the auditor who is required to sign the audit opinion in his or her own name, for and on behalf of the audit firm (s.503 Companies Act 2006), duplicates the deterrent effect of the FRC's sanctions regimes, and could even lead to the collapse of a firm.

Question 7

In relation to financial penalties are they being set at the right level?
In answer to this question, respondents are invited to state;
(a) whether they think they are too low or too high, and
(b) by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.

In our view financial penalties are currently being set at a level which is too high, without any clear basis for the level of the sanction. There appears to be no link between the sanction imposed and the underlying conduct, and the lack of a clear methodology for setting fines leads to the perception that the process is arbitrary and does not distinguish between different types of conduct (e.g. honest mistake, deliberate action and breach of a regulation).

Under the Sanctions Guidance, sanctions can be imposed for 'misconduct', where judgements have been made that in hindsight were incorrect, but which do not undermine the audit (i.e. an "honest mistake"). By way of contrast, sanctions can also be imposed under the Sanctions Guidance in cases where the misconduct amounts to dishonesty or lack of integrity, where an audit partner was knowingly involved. In these latter cases, there should, in our opinion, be a step change in the level of financial sanctions imposed on the individual.

The Sanctions Policy (of which we have no practical experience) applies to very different types of conduct from the Sanctions Guidance; rather than acts of 'misconduct', the Sanctions Policy applies to a wider range of breaches of

"Relevant Requirements" (i.e. rules or regulations). In our opinion, it would be appropriate for sanctions imposed on individuals under the Sanctions Policy to be significantly lower, depending on the gravity of the breach, than those imposed for the misconduct of individuals under the Sanctions Guidance.

The financial sanctions imposed by the FRC are significantly higher than those imposed by other regulators, for example, the PCAOB in the US where recent financial penalties on audit firms have been in the range of US$10,000 - US$25,000. The figures in Appendix 3 to the Call for Submissions show clearly that not only are financial sanctions significantly higher in the UK, but also that they are increasing year on year. A review of sanctions regimes elsewhere in Europe, indicates that there is no consistent approach taken, but we note that a number of territories impose a cap on the financial sanctions that may be imposed on audit firms, and/or statutory auditors. However, there is no harmonisation between the levels of the caps imposed.

At a time when the FRC's Audit Quality Review results are improving, we believe that imposing higher sanctions year on year, together with the consequent adverse press coverage, risks damaging the public perception of the audit profession, with unforeseen and unintended consequences for both audit firms and individual auditors. These implications could have a negative impact on the future of audit, and run contrary to the FRC's stated objective of improving audit quality, as follows:

- a reduction in competition and choice in the audit market, especially if increased exposure to financial and reputational risk drives firms out of the market; and
- a negative impact on the attractiveness of the audit profession as a career, due to the increased risk of high financial sanctions and damage to reputation, which may in turn have a negative impact for industry in the UK, as many leaders of industry come from an audit and accountancy background.

Question 8

If respondents think that financial penalties are too low is this because:
(a) failures of the type covered by the procedures require greater censure than is currently given;
(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;
(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;
(d) they do not promote public confidence; or
(e) some other reason?

In our opinion financial penalties are too high - see our response to Question 7 above.

Question 9

What are the key elements in achieving effective deterrence?

The behaviour giving rise to the sanctions should not be viewed by any party as quasi-criminal, except in the limited instances of a deliberate act and, as such, we suggest that the FRC's focus should be on improvement rather than deterrence.

In our opinion, the key elements in achieving effective deterrence are as follows.

- The potential for, or actual, reputational damage - this exists already under the current regime. For individual audit partners the damage to reputation can be considerable notwithstanding that at the time of the announcement there is no finding of misconduct or breach as the case is not determined.

  Under the Audit Enforcement Procedure and the Accountancy Scheme the FRC has exercised its discretion to publish actions, including its decisions to investigate. In our opinion, the publication of the outcome of an investigation, together with details of the sanction imposed, would achieve the required deterrent effect (see our response to Question 4 above).

- The imposition of sanctions in a more timely manner would help to achieve an effective deterrent. FRC investigations currently are lengthy, and sanctions are often imposed several years after the events in question.

Question 10

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

See our response to Question 9 above.

Question 11

Should there be greater use of non-financial sanctions such as:
(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or
(b) an order for some form of restitution?

Both the Accountancy Scheme and the Audit Enforcement Procedure permit a range of non-financial sanctions which may be imposed either on their own, or in combination with other sanctions, including a financial sanction. We note from Appendix 3 to the Review Panel's Call for Submissions that, since January 2009, non-financial sanctions (other than reprimands and severe reprimands, both of which signify disapproval) have been used rarely.

Whilst the deterrent effect of the sanctions regime is important, we suggest that the FRC's focus should be on improvement. Given that the focus of so many past cases has been on the judgement of the auditor, any enforcement regime must consider steps that can be taken to improve the quality of those judgements and/or the checks and balances imposed on them. In our opinion, a collaborative approach such as this would be far more effective in enhancing public confidence in audit and supporting continuous improvement in audit quality than the current regime, which is focused on deterring deliberate poor behaviour. Consequently we suggest tribunals and decision-makers should consider making greater use of other non-financial penalties that are available, for example an undertaking requiring that staff in a member firm are subject to mandatory training (under para 23 of the Sanctions Guidance for the Accountancy Scheme and paras 67 - 72 of the Sanctions Policy), and also that any such undertakings imposed by the FRC should be actively monitored.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance 2, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:
(a) operating satisfactorily; or
(b) inappropriate, and, if so, why?

In our experience, the FRC's discount for admissions and/or settlement under the Accountancy Scheme does not operate effectively in that it does not incentivise either the FRC or firms to have meaningful discussions either on discounts or on settlement.

We cannot comment on the FRC's discount for admissions and early disposal arrangements under the Audit Enforcement Procedure or the Actuarial Scheme as we have no experience of these in practice. With respect to the discount for admissions and/or settlement under the Accountancy Scheme, we make the following points.

1. The Sanctions Guidance lists settlement factors which may be applied to each of three stages in an investigation (para 59) as follows:

- stage 1 - the largest reduction (between 20% - 35%) applies if settlement is reached at the point between the decision to commence an investigation and delivery of a formal complaint;
- stage 2 - between the delivery of a formal complaint and the commencement of the hearing of that complaint the reduction is up to 20%; and
- stage 3 - there is no reduction between the period following the commencement of the hearing of the complaint and the conclusion of the case.

Whilst we have no practical experience of the Sanctions Policy, we note that there is a similar procedure for early resolution (at paras 73 - 77), but that the percentage reductions are not consistent with the Sanctions Guidance (Accountancy Scheme/Actuarial Scheme). For example, the Sanctions Guidance gives a discount of up to 20% at Stage 2 (see above), but the Sanctions Policy gives a 5% - 15% reduction at a similar stage. However, in our experience:

(a) it is not clear to what figure (i.e. financial sanction) the reduction is to apply;
(b) there is no transparency or predictability as to how the discount is set within the range;
(c) the starting point for negotiations is unlikely to reflect a rigorous assessment of the case by the FRC's conduct division; and
(d) the position on costs under the Accountancy Scheme, whereby the FRC, as the regulator, is afforded a degree of protection on costs, which is not shared by the auditor under investigation[14]. This is in contrast to civil litigation, where either party can expedite settlement, and ensure some protection from the other party's costs, by use of a Part 36 offer or a Calderbank offer. The position on costs under the Accountancy Scheme means that settlement discussions are weighted in favour of the FRC, and consequently there is less incentive for the FRC to reach a settlement.

For the system to incentivise firms and individuals, these points need to be addressed and there needs to be a willingness on the part of the FRC to engage in an open and constructive two way dialogue on settlement, and to apply discounts for admissions.

2. Under the Sanctions Guidance, there is no distinction in the context of discounts for admissions or settlement negotiations between cases which are honest mistakes, and those which involve dishonesty and/or lack of integrity on the part of the individual auditor and/or the firm. If the system is to incentivise firms and individuals to consider admissions and/or settlement, a distinction should be made between such cases;

   We recommend that the FRC has regard to the operation in practice of the FCA's early settlement procedure. The FCA creates an early settlement dynamic by indicating the areas it requests the party to admit to and the penalty which it seeks. This triggers the first and largest discount to penalty available under the early settlement scheme.

3. The Sanctions Guidance and the Sanctions Policy (of which we have no practical experience) apply to very different types of conduct; the Sanctions Guidance applies to acts of 'misconduct' whilst the Sanctions Policy applies to breaches of "Relevant Requirements" (i.e. rules or regulations). However, we suggest that it would be appropriate for the same starting point for discounts for admissions and/or settlement to apply to sanctions relating to acts of misconduct under the Accountancy Scheme, and to (lower) sanctions for breaches of Relevant Requirements under the Audit Enforcement Procedure.

Question 13

Are there some sanctions which could usefully be imposed which are not currently available?

There is a wide range of possible financial and non-financial sanctions available under the Audit Enforcement Procedure and the Accountancy and Actuarial Schemes, and there are no other sanctions that we would suggest. However, we would recommend that consideration is given by the FRC to making greater use of other existing non-financial sanctions that are available under the Sanctions Guidance and the Sanctions Policy (see our response to Question 11).

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[14] Para 9(8)(ii) Accountancy Scheme

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APPENDIX II

THE ICAEW AND FCA SANCTIONS REGIMES

Summary of the ICAEW regime

The ICAEW Guidance on Sanctions[15] gives a suggested starting point for financial and non-financial sanctions of each type of complaint, which gives the regulatory and conduct committees an indication of where to start when deciding on a sanction. The financial sanction will either be an absolute amount, or will be based on a multiple of the fees charged (typically where the complaint relates to poor audit or accounting work and is made against a firm). Once the appropriate starting point has been agreed, aggravating and mitigating factors can be identified and taken into account in deciding to reduce or increase the penalty from the suggested starting point. The Guidance gives examples of aggravating and mitigating factors for each type of complaint.

This approach ensures compliance with Reg 5(3) The Statutory Auditors and Third Country Auditors Regulations 2016 (SI 2016/649) (SATCAR), which requires that:

'In determining the type and level of sanctions to be imposed under this regulation, the competent authority must take into account all relevant circumstances, including–
(a) the gravity and duration of the contravention;
(b) A's degree of responsibility;
(c) A's financial strength;
(d) the amount, so far as can be determined, of profits gained or losses avoided by A;
(e) the extent to which A has co-operated with the competent authority;
(f) any previous contravention by A of a relevant requirement.'

By way of example, the starting point for poor audit work is given in section 9(b) of the ICAEW's guidance as follows:

Audit work of a seriously defective nature	***Firm*** *Severe reprimand and a financial penalty equal to 1.5 x audit fee. Adjust upwards if audit fee inadequate or if company subsequently collapsed.*
	RI/second review partner *Exclusion and a financial penalty of £5,750- £11,500*

Aggravating and mitigating factors for complaints in relation to audit work are given in the Guidance. Aggravating factors include whether the audit was of "a plc or public interest entity", and whether the work was on multiple accounts over an extensive period of time. Mitigating factors include whether there was an inadvertent breach or the breach of requirements had no consequences, and whether subsequent audits were found to comply with requirements.

Summary of FCA approach

The FCA's sanctions procedure is outlined in the Decision Procedure and Penalties Manual[16] (the Manual) at para 6.5A.2(3). The FCA's overall approach to financial penalties is set out in Chapter 6.5 ("*Determining the appropriate level of financial sanction*") and is based on disgorgement so that there is no benefit to the firm from a breach plus a penalty for wrongdoing and a deterrent element (para 6.5.2).

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[15] https://www.icaew.com/-/media/corporate/files/about-icaew/what-we-do/protecting-the-public/complaints-process/guidance-on-sanctions.ashx
[16] https://www.handbook.fca.org.uk/handbook/DEPP.pdf

The Manual states that the financial penalty is made up of two elements, being disgorgement and a financial penalty that reflects the seriousness of the breach (para 6.5.3), and gives detailed guidance as to how these amounts are determined.

The starting point is the disgorgement element which is the financial benefit from the activities that have given rise to the breach (para 6.5A.1). The figure that reflects the seriousness of the breach is based on the "relevant revenue" (i.e. the revenue derived by the firm during the period of the breach from the products or business areas to which the breach relates) to which a percentage of between 0% and 20% is applied, depending on the seriousness of the breach, with factors given to assess the seriousness (para 6.5A.2).The seriousness (but not the disgorgement) element of the penalty can be adjusted by aggravating and mitigating factors (para 6.5A.3), and if the resulting figure is not considered sufficient, para 6.5A.4 sets out the circumstances in which the penalty can be increased further. Para 6.5A.5 gives the option for settlement discounts.

This approach has the advantage of transparency, flexibility and results in a demonstrably proportionate financial sanction.

pwc

APPENDIX III

AUDIT QUALITY: PwC's INVESTMENT IN, AND RECORD ON, AUDIT QUALITY

Set out below is a summary of how we invest in audit quality, our record on audit quality and the relatively small number of our audits which are the subject of FRC enforcement procedures.

1. **Investment in audit quality** - We take our responsibilities to provide assurance services of the highest quality very seriously, and we are committed to continuing to invest in our assurance practice. For example, the investment we make in training our people, as well as in assurance research and development is substantial. In our 2016 Transparency Report[17], we reported that for the year ended 31 December 2015, our partners and staff undertook 1.38 million hours of training. Excluding staff under training contracts, this equates to 91 hours per person (approximately 5.5% of a standard working year). We also invest heavily in our internal quality control systems, covering leadership responsibilities for quality within the firm; relevant ethical requirements; acceptance and continuance procedures; human resources; engagement performance; and monitoring. Our Transparency Report describes in detail how we incorporate these elements into our systems and processes.

2. **Our record on audit quality** - Our performance in respect of audit quality is also regularly checked. We are reviewed annually by the FRC's Audit Quality Review (AQR) team, and the results of those reviews are published. Our AQR results for 2016/17 show that 93% of all PwC audits inspected by the FRC's AQR team were good, with limited improvements required (2015/2016: 84%; 2014/2015: 72%) - these results indicate that quality is improving. Indeed, the FRC's stated target is that 90% of all FTSE 350 audits inspected should be assessed as good or requiring limited improvements by 2019[18], and we have exceeded that target in 2016/17. However, we are not complacent, and where any of the reviews show that improvement is required to a PwC audit, we undertake rigorous root cause analysis to understand areas for improvement and take remedial action.

3. **No endemic or systemic issues in audit** - We note that the number of audits subject to FRC formal investigations continues to be small relative to the number of assurance engagements undertaken, suggesting there are no endemic or systemic issues in audit. From a review of the FRC's investigations spanning the decade 2007-2016, we observe that from a PwC FTSE 350 client base of some 96 to 114 clients each year, only two have been investigated by the FRC with findings of misconduct.

[17] https://www.pwc.co.uk/annualreport/assets/2016/pdf/annual-report-2016-transparency-report.pdf
[18] https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Developments-in-Audit-2015-16-Full-report.pdf

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Ms Noranne Griffith
Secretary to the Review Panel
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29 June 2017

Dear Ms Griffith

Independent Review Panel on Sanctions

1 Introduction
We welcome the opportunity to respond to the questions posed by the Independent Review Panel on Sanctions. This response is a joint one between the Group A accountancy firms and the members of the Association of Practising Accountants (we have appended a list of all of the firms which have subscribed to the response), namely the medium-sized firms that are active in the accountancy and audit market, including that for smaller listed and larger unlisted companies and SMEs[1].

2 Merit of reviewing the disciplinary model itself
We believe that the Review Panel's work has the potential to impact favourably the way that the professional disciplinary system delivers public confidence but that in order to do so, it should be asked by the FRC to review not merely the sanctions aspect of it but the disciplinary *model* itself. We are concerned that there is currently significant overlap between the AEP and the ARSP.

3 Care needed not to overemphasise financial sanctions
We are concerned that there is a risk of assuming firstly that sanctions should be principally financial in nature and secondly that the higher the financial sanctions the more effective the regulatory system. In fact the reverse may be true.

4 Need to explore alternative regulatory models
We believe it is vitally important to explore the nature of the regulatory model that would most likely lead to the highest levels of audit quality and, in this context, consideration should be given to alternative regulatory approaches such as that of the Civil Aviation Authority based on high levels of sharing of information on problems/failures between the regulator and the regulated. The aim must be to create a learning culture where areas for improvement are identified and implemented on a timely basis and, where applicable, shared across the sector. This is more likely to happen where concerns on financial sanctions are not to the fore. In saying

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[1] Group A - Crowe Clark Whitehill, Haines Watts, Kingston Smith, Mazars, Moore Stephens, RSM, Saffery Champness, and Smith & Williamson; APA – Armstrong Watson, BHP, Blick Rothenberg, Brebners, Buzzacott, Dixon Wilson, Duncan & Toplis, James Cowper Kreston, Kreston Reeves, Mercer & Hole, Price Bailey, Roffe Swayne, and Shipleys.
In total, our firms have annual revenues of £1.1bn+, with 12,600 partners and staff in 230+ offices around the United Kingdom.

this, it is fully recognised that there are circumstances when financial sanctions will be justified especially, for instance, where there has been a deliberate violation of requirements.

5 The risks associated with increasing financial sanctions

In reviewing the use of and the appropriate levels of financial sanctions it is important to be conscious of the risks associated with them. We would identify two in particular:

- there is currently a real danger that the most able young accountants will be dissuaded from a career in auditing and will instead choose other specialisms due to concerns about the risk of financial sanctions and loss of professional reputation when an audit failure occurs
- high levels of financial sanctions may dissuade new firms from entering the listed audit market increasing the risk of 'regulatory capture' due to the current high levels of concentration in the listed audit market which would become unsustainably high were one of the existing largest players to leave the market without new entrants being present to relieve the resulting pressure.

Our detailed answers are set out in the attached Appendix.

Given the importance we attach to the consultation, we would welcome the opportunity for representatives of Group A and APA to meet with the Independent Review Panel on Sanctions to discuss our response.

Yours sincerely

T M McMorrow

T M McMorrow
Secretary to the Firms

contd.

Appendix: Responses to individual questions

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We believe consideration needs to be given to whether the AEP and ARSP should be merged given the substantial degree of overlap between them and, linked to this view, whether the Sanctions Guidance and Sanctions Policy should remain separate from each other.

There is a high degree of duplication between the two policies which, though not surprising given that they were written in short sequence, is unhelpful to users – it is not only a question of having to close-read for inconsistencies between them but also involves assessing whether there are different nuances between them.

We are not persuaded that two separate sets of procedure are needed and linked to this overarching view are not convinced of the merits of separate guidance on sanctions in respect of each of them. The range of sanction common to both is wide, from reprimand to loss of audit practising rights so that it is hard to see when one Procedure would be adopted as against the other in any given set of circumstances.

The objective of the AEP is to fulfil EU and Statutory Instrument law, obliging the FRC to ensure that "effective systems of investigations and sanctions to detect, correct and prevent inadequate execution of the statutory audit" are in place.

The objective of the ARSP is to address situations where "...a Registered Auditor has failed to comply with the Regulatory Framework for Auditing and: (a) their continued registration or their continued registration without restrictions or conditions could adversely affect a Major Audit Client, Major Local Audit Client, Third Country Audit Client or any other person; and/or (b) it is necessary to impose a Sanction to ensure that their Statutory Audit Functions, Local Audit Functions or Third Country Audit Functions are undertaken, supervised and managed effectively.

There do not seem to be any major differences between these objectives, and as a result no continuing reason to maintain both going forward: in the absence of any real difference in scope and in the range of sanctions to be applied, it is difficult to see why two processes (and therefore two sets of sanctions guidance) need to be maintained.

In addition to providing clarity for audit firms, having only one procedure and one set of sanctions guidance would also we believe be helpful from the point of view of the FRC's executive.

We also suggest that the outcome of this consultation be informed by those of the further work that the Review Panel will embark on later this year, so that instances of 'mutual impact' of change in the round can be measured rather than confined to silos.

Question 2

Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

We believe there have been significant improvements in audit quality and in governance in recent years and given that the current sanctions system has only recently been introduced we do not consider it would be wise to over react to press criticism of the level of fines in a small number of instances.

The definition one attributes to 'in current circumstances' will depend on stakeholders' views and perspectives but it is as well to offer an assessment of what those circumstances are, as agreement in this respect may allow sanctions policy going forward to be predicated on agreed, shared, assumptions.

contd.

We firmly believe audit quality in the round continues to improve, a matter of empirical evidence supported by successive AQR and QAD reports:

- audit firms' training and the degree of emphasis on technical competence have improved substantially since the financial crisis;

- the governance framework (corporate and that of audit firms) is growing more sophisticated;

- investors' relationships with the major audit firms are more meaningful and regular;

- the ethical climate is governed by a framework which is only a year old and which was itself determined through active engagement by the FRC with many of the same stakeholders who will be responding to the current consultation;

- the prevailing government attitude is to shape regulation so that it supports industrial and commercial growth; and

- if our perspective set out above is largely shared by stakeholders, we believe it is important that there not be an over-reaction to some press criticism on the level of fines imposed in a small number of instances.

Question 3

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

We do not consider some form of tariff or guideline would be helpful and believe there is a risk of purely focusing on financial sanctions when this is not intended to be the case.

Reference to any kind of tariff presupposes that sanctions should predominantly be financial. In our view, the 'case-law' of the AADB tends to show just that, and gives insufficient weight to the value of those other options set up in the Procedures directed towards overt protection of audit quality.

For example, Para 21(o) of the AEP guidance presupposes that undertakings given by firms will often adequately address audit failings and we believe that, in order to fulfil the intention of both policies, "to promote proportionality, clarity, consistency and transparency in decision-making", this should be made explicit in the guidance.

Both sets of guidance refer to 'conditions', but not consistently: in the AEP guidance, the references to conditions are in the context of the following paragraphs:

Para 38 says, "A Decision Maker may order a Statutory Auditor or Statutory Audit Firm to comply with any direction that it considers, in its absolute discretion, appropriate. By way of example and without limitation to the Decision Maker's general discretion, such direction may require a Statutory Auditor or Statutory Audit Firm to undertake or implement education or training programmes, or to comply with particular requirements when practising (including restrictions on the nature of any work undertaken)."

Para 39 adds, "This sanction is intended to be used by Decision Makers where the circumstances suggest that the public interest would be best served by requiring the Statutory Auditor or Statutory Audit Firm to take particular actions with a view to:
a) improving the professional competence of a particular Statutory Auditor;
b) ensuring that all partners or personnel in a Statutory Audit Firm receive training in a particular area of practice;
c) ensuring that a Statutory Audit Firm implements organisational or administrative arrangements that would avoid a repetition of the breach of the relevant requirements;

d) preventing a Statutory Auditor or Statutory Audit Firm from undertaking engagements that, based on the breach of the relevant requirements established, that Statutory Auditor or Statutory Audit Firm is not competent to undertake (for example by directing the Statutory Auditor or Statutory Audit Firm not to undertake audits of entities of a particular character — for example, of a charity or a publicly listed company)."

We advocate much greater use of conditions (in the sense of undertakings, which we refer to elsewhere in this response). Human error is inevitable in any profession and isolated instances of truly personal professional failure should not cause the audit firm's practising rights to be jeopardised.

Question 4

In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

We consider that, as at present, when sanctions are imposed on the firm and/or individuals the deciding factor should be the perceived degree of culpability of the different parties involved, and differentiate the consequences of isolated, individual failings from the firms' overall performance.

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

We believe the current system for determining sanctions remains broadly appropriate and are not persuaded of the need for a starting point.

This is an issue with which the Courts have struggled for years and we would favour the Decision Maker or Tribunal or AQR Committee to have an unfettered discretion, tempered by the considerations in paras 21 of the AEP guidance and para 23 of the ARSP (mitigating and aggravating factors).

The adoption of any tariff, though non-binding, does encourage decision-making to depart from it only in exceptional circumstances. This may in turn be inimical to the application of the Proportionality principle: to give a practical example, there are now a number of firms which are involved in the audit of non-systemic PIEs[2]. Though accepted public policy suggests that firms carrying out audit work of that kind is to be welcomed, the information in our hands as a group is that the sanctions regime is a severe disincentive, and the more so if financial sanctions become tariff-based.

Firms emphasise in their training of young auditors that they should concentrate on having demonstrably complied with ISAs and to face regulatory inspection secure in that knowledge. The sanctions regime, however, causes those same young auditors a disproportionate level of concern and an uncertainty that, even if they have applied the ISAs faithfully, they could still fall foul of a financial or other sanction: we refer to this education *versus* sanction dichotomy elsewhere in our responses and it is a real issue so far as the attraction and retention of good-quality auditors is concerned.

[2] It may also be worth noting that the capital requirements for a main listing being lower than for an AIM one, there is some evidence to suggest that companies are seeking a standard listing in preference to AIM. These entities are AIM in all but listing, and thus typically, certainly at the outset of building a business, are not well resourced in matters of financial reporting. They thus present a specific risk to audit firms, who, but for the standard listing, would (save those which may have Forum of Firms obligations) be able to make use of the FRC's relaxed stance on NAS and thus assist in improving the financial reporting for these entities. Smaller firms should not be discouraged from auditing smaller-cap PIEs which are as much in need of guidance in financial reporting as AIM entities, but for whom less can be done under the FRC Ethical Standard. Simply another application of the Proportionality principle, in our view.

contd.

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

We do not consider the current sanctions regime is currently operating in a fair and proportionate manner. We believe financial sanctions rather than other ones are used too frequently and, linked to this, consider that greater distinction should be drawn, in the interests of natural justice, between deliberate violations of requirements and those which result from unintended failings. A reformed approach based on the regulators and audit firms working together to identify lessons learned and implement the necessary reforms could be far more effective in enhancing audit quality.

Our view is that the *most commonly used* sanctions do not optimally meet the regulatory objectives. Cases take too long to be concluded as a result of which the findings seem to relate to long past events and thus do not have the same impact as if they were determined in a more timely fashion. It is also not fair for those involved in cases to have to wait unduly long before knowing the outcome and it places them under enormous and unfair pressure.

Moreover, we consider that public sanctions (and all are required to be published in terms of the publication policy) should be primarily reserved for instances where the wrongdoing is of a grave nature and where a lack of integrity is evidenced.

Whereas 'deliberate violations' deserve public opprobrium, other failings far less frequently do, yet the guidance does not make that distinction.

On the assumption that when things go wrong, they have one or more proximate causes these need to be identified rapidly so that the lessons learned can be as rapidly as possible disseminated to practitioners. The most commonly-voiced justification for sanctions-led discipline is that it discourages bad behaviour. Whereas that may be true in cases of deliberate violations, their frequency is low and it is not generally true, for instance, of technical competence-related cases.

Furthermore, there is a real risk of bright young accountants deciding to specialise in areas other than audit due to the risks to their career if they make a mistake as an auditor. This is a significant issue and a failure to address it will have major adverse long-term effects on the auditing profession.

Other professions' regulators address the overall issue of things going wrong not from the professional discipline end of the telescope but from a root cause analysis that takes place as soon as possible after the event bringing the investigation. Absolutely key to the process is that real-time conversations between investigators and professionals take place in a legal 'safe harbour' in which representations and admissions made are not competent or compellable in any disciplinary or litigation context: the whole emphasis is discovery of what brought the event about, how it can be prevented for the future, and how lessons learned can most effectively be cascaded out to the practising community.

Learning from failure is complex but the traditional professional disciplinary model makes it much more so - the current systems are unduly adversarial and rather outdated and there is a need for significant reform with the emphasis on context-specific learning strategies.

The very real danger of this consultation is that it might only lead to an ever-greater reliance on financial penalties and that these will escalate, which in turn will increase the regulatory risk profile for audit firms. Moreover, it is not just the size of financial penalties but the concomitant reputational damage that needs to be taken into account. Additional firms need to be encouraged to enter the listed audit market but if the risk of heavy penalties dissuades them from doing so the reduction in competition is likely to have an adverse impact on the market especially as it increases the risk of 'regulatory capture' as the regulator will be aware that if any of the four firms were to leave the market by reason of the kind of catastrophic failure that is not without precedent, it would be difficult to maintain its viability.

contd.

It is not essential to go down an ever more punitively severe path: the two sets of existing sanctions policy guidance already provide for the settlement of cases by undertakings of the firms but this seems not to be a commonly adopted approach.

We advocate that a study be undertaken of whether the current system should be reformed in which greater emphasis is placed on 'root cause analysis'. A safe harbour around FRC/AQR/audit firm, ensuring that evidence and admissions could not be used in any context, regulatory or legal, might, the study may conclude, lead to better and faster learning-points leading to an overall improvement in audit quality.

That study might also conclude that formal disciplinary proceedings need only be instituted where the conduct complained of has more to do with questions of integrity (false representations, for example) than technical competence.

Question 7

In relation to financial penalties are they being set at the right level?

As emphasised, we do not believe the current primary focus on financial sanctions leads to the best regulatory outcomes. We do not believe there is evidence that suggests that the current system where fines are determined by a Tribunal with knowledge of the particular case needs to be changed.

It is difficult to draw any conclusions from the limited jurisprudence of decided cases and we would venture to suggest that questions of correctness of 'level' are not likely to produce reliable results. We have already said that we do not believe that the current emphasis on fining firms best serves the regulatory objectives, a conclusion that is predicated on our belief that serving those objectives optimally needs a fundamental review of technique and process.

The vast majority of audits are, of course, of non-PIE entities and whereas there is legitimate regulator-concern over those major corporate failures which always take the public's eye, most audit is of companies which carry no likelihood of systemic failure – a focus on financial sanctions in this significant tranche of activity does not seem optimal.

Question 8

If respondents think that financial penalties are too low is this because:

(a) failures of the type covered by the procedures require greater censure than is currently given;

We would strongly disagree with any suggestion that decisions on financial sanctions arrived at by Tribunal are wrongly fixed.

(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;

Consistent with our answer to (a), and since proportionality of sanction and how to arrive at it are already provided for in both sets of guidance, we do not believe that financial penalties are fixed at too low a level. We stress again the need for demonstrable fulfilment of the Proportionality principle, especially as it relates to audit firms whose activities do not affect the capital markets in the systemic sense.

(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;

We have taken issue elsewhere in our answers as to the connectivity of sanctions and the fact of deterrence. It therefore follows that we are not persuaded of the link between financial sanctions and being incentivised to do a better job.

contd.

(d) they do not promote public confidence;

Any purported correlation between the reporting of fines for professional disciplinary cases and increases/decreases in public confidence seems to us to rest on an unsafe conclusion – if other stakeholders complain of mistrust of the audit profession, such will bear this proposition out. A far more desirable metric of the promotion of public confidence would be the faith that the public could have in the speedy and comprehensive identification of lessons to be learned from failure and how well it had been addressed. Neither the AEP nor the ARSP (and consequently the guidance written under them) provides the kind of searching assurance through process that would be needed to achieve that effect.

or

(e) some other reason? No.

As previously discussed, we do not consider that financial penalties are too low.

Question 9

What are the key elements in achieving effective deterrence?

We believe the aim of the regulatory system should be to enhance audit quality not to achieve effective deterrence.

Consistent with the balance of our answers, we think that the *system* we have in place for disciplining auditors is not the most suitable *model*. Deterrence is an unsafe provider of improvement in professional competence: the shared, collaborative, interrogation of the root causes of failure (an inquisitorial approach used, for example, by the Civil Aviation Authority) is a much more reliable model, which ought to drive fundamental changes to the system. In our submission, the Review Panel could usefully be asked, in further consultation, to explore the efficacy of the suggested model.

Question 10

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

Consistent with what we have said elsewhere in our answers, we see little positive causation between sanctions and either deterrence or incentivisation.

Question 11

Should there be greater use of non-financial sanctions such as:

(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training

and/or

(b) an order for some form of restitution?

As we have already said, we see substantial value in the use of *undertakings* from firms to drive improvements where deficiencies have been identified by AQR.

However, the application of conditions in effect generally means changing/diminishing firms' licensed practising rights (because they restrict the conditions under which firms conduct statutory audit). We would urge the Panel to consider how well the use of undertakings from firms achieves improvement before considering whether the more frequent imposition of conditions is either desirable or necessary.

Restitution is a complex notion more suited to the application of the civil law than professional discipline.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions

Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

(a) operating satisfactorily;

or

(b) inappropriate, and, if so, why?

We believe the current system places undue pressure especially on those in smaller firms to accept a discounted sanction due to concerns about escalating legal costs and the sanction if they do not make an admission.

Question 13

Are there some sanctions which could usefully be imposed which are not currently available?

We conclude our answers to the consultation on the main point of emphasis with which we began it: we believe that it is inappropriate to focus on one part of the disciplinary scheme without first having looked at the overall model.

Where professional failures occur (and this is true of every profession), those failures generally offer many opportunities to learn and thereby enhance audit quality. From a public interest point of view, this should be the primary goal of the system and everything else should be subordinate to that end.

Saffery Champness
CHARTERED ACCOUNTANTS

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3 July 2017

By email only n.griffith@frc.org.uk

Ms Noranne Griffith
Secretary to the Review Panel

Dear Madam

Independent review of Financial Reporting Council (FRC) sanctions

Thank you for inviting us to make a submission in respect of the above review. Saffery Champness LLP is a signatory to the submission from the Group A firms, but we would also like to take this opportunity to outline our own thoughts directly.

In our experience some standard listed PIEs are on the London Stock Exchange (LSE) because less capital is required for a cash shell to obtain an LSE standard listing than an AIM listing. It is probably safe to say that if the capital raising targets were the same, some of these businesses would list and remain on AIM.

Our PIE client base includes such businesses. PIEs of this size need to have this choice in the audit market. Unfortunately being a mid-size firm auditor of PIEs has become a less palatable position since the apparent trend of fines being the 'go to' sanction.

We are committed to maintaining our skills and competence such that we can audit PIEs. Staff find the challenges of PIE audits fulfilling and in order to attract and retain quality audit staff we wish to be able to offer them this opportunity. We also want to be able to offer our services to smaller PIEs; we find that they like the way in which we conduct our audit work as it is effective and responsive to their needs.

We would welcome a sanctions regime under which the FRC were committed to, in the first instance, a collaborative, root cause analytical and follow up educational exercise. This would we feel present a more positive environment within which our firm and trainee auditors can practise.

Yours faithfully

Saffery Champness LLP

Saffery Champness LLP

Sanctions Review Panel

https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/May/Independent-review-of-Financial-Reporting-Council.aspx

Submissions from Enforcement

These submissions are made by the Enforcement Division based on the experience of dealing with sanctions since 2012 in cases where a Tribunal has made Adverse Findings of Misconduct under the Accountancy Scheme or where there has been a settlement under the Accountancy or Actuarial Scheme.
We limit our submissions to matters of a practical nature to assist the Review Panel and we do not make any submissions on policy. Therefore we have not responded to the majority of the questions.
We make no specific point on the Sanctions Policy under Audit Enforcement Procedure and we will refer to the Sanctions Guidance (SG) throughout. Some points will, of course, be common to both.

Question 2

Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Comments:

Our overall view is that it would be wrong to characterise the SG as not “fit for purpose”. However, in a number of respects we find the SG lacking clarity, repetitive and contradictory. We accept that sometimes there will be repeat factors in different sections but it is not always clear, at each stage, how the same factor should be considered. We use as an example paragraphs 32-34 SG. The references to a Member’s financial resources or remuneration are important and relevant but the SG could provide greater clarity as to the facts that should be taken into account.

<u>Starting Point</u>

This is the most important figure to assess for financial sanctions because it enables those considering the facts of the case to understand the seriousness and to be able to predict what may be appropriate in future cases. It also achieves consistency. The ultimate fine imposed will usually be a different figure because of factors specific to the facts or circumstances of the case and the Member or Member Firm involved.
We note that in most, if not all, decisions from the Tribunal the starting point for financial sanctions cannot be discerned. In recent Settlement Agreements the parties have sought to identify a specific starting point.
We would welcome guidance on the need for a specific starting point and how it should be assessed.

Question 3

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

Comments*:*

While we would not argue for an overly-prescriptive methodology in setting guidelines, we do believe that a tariff related to clear criteria (e.g. firm revenue) could introduce a welcome degree of certainty and objectivity. Any revised guidance would of course need to retain sufficient flexibility to properly reflect the diverse range of cases with which we deal.

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

Comments*:*

See comments above at Question 2.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions: (a) operating satisfactorily; or (b) inappropriate, and, if so, why?

Comments*:*

We are strongly of the view that the time periods, and the ranges of percentage discounts, should be reviewed to ensure that there are far greater incentives for early settlement. The bands allow for an overly generous discount to be available for longer than is appropriate. This is a very important mechanism to achieve an outcome as early as reasonably possible and to encourage all parties involved in the cases to identify what admissions are required and what sanction(s) should be imposed. Substantially the same issues arise under the Schemes as under the Audit Enforcement Procedure.

Submission from Fidelity International to the Review Panel examining the Financial Reporting Council's Enforcement Procedure Sanctions

We are pleased to have this opportunity to respond to your review of the Financial Reporting Council's ("FRC") Enforcement Procedure Sanctions. Fidelity International ("Fidelity") has £234 billion of assets under management with approximately £20 billion invested in UK listed equities and with almost all of these funds being under active rather than passive investment mandates.

1. Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

One of the principal stated aims of the FRC's Disciplinary Scheme is to maintain and promote public and market confidence in the accountancy profession but it is not clear to us that simply seeking to prevent misconduct by members of the profession is sufficient to achieve this objective. One possibility would be to promote a framework which encourages members to be seen to act to prevent misconduct on organisations where they are employed or to which they provide professional services. We do not expect auditors to become detectives but where they should reasonably have known something was not as it should be there should be a requirement for them to report their concerns.

2. Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

We think the Sanctions Guidance/Sanctions Policy is satisfactory and fit for purpose in current circumstances but question whether the policy shouldn't cover non-audit in addition to audit-related work. We support your view that the primary purpose of imposing sanctions for acts of misconduct is not to punish, but rather to encourage members to act responsibly and in the public interest. Counterparties who have lost money from acts of misconduct can seek redress in the Courts.

3. In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

We do not think that there is a need to adopt specific tariffs or detailed guidance.

4. In imposing sanctions should decision-makers seek any particular focus on entities rather than individuals or vice versa?

Both individuals and entities are equally important in the maintenance of professional standards. Individuals must know that their professional reputation and employment are on the line if they act inappropriately or commit a sin of omission whereas entities must be encouraged to invest enough in their professional review function to increase the probability of finding errors or evidence of collusion or lack of professional scepticism.

5. In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

There should be a framework to define the penalties for both individuals and entities. In the case of individuals we would suggest that life-time income and the the remaining period until natural retirement should be the determinants of the size and duration of any penalty. For example a 3-5 year exclusion and a fine equivalent to say 50% of prior year income is a limited deterrence to a 63 year old who has significant savings and is near the end of his/her career, whereas the same penalty imposed on a 35 year old could be life changing. In the case of entities we would recommend that when determining the size of any penalty, prior track record should be taken into account as well as the total amount of UK revenues from all professional services.

6. To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

We do not have sufficient information to be able to answer this question but it would be informative to compare the frequency of restatements and the number of instances of fraud and misconduct in the UK relative to other developed markets.

7. In relation to financial penalties are they being set at the right level?

Once again we do not have sufficient information to be able to this question fully but we don't think that fines of less than £5 million are likely to be major deterrent to any of the big four firms. In the case of individuals we note again that the particular circumstances of the individual in question should be taken into account when determining the appropriate level of penalty. In some instances we would not regard the penalties imposed as having been sufficient, and life-time bans from the profession should be applied more widely. It would also be interesting to track the the subsequent careers of any individuals who have suffered a penalty as this may give you a better understanding of the full consequences of your measures.

8. If respondents think that financial penalties are too low is this because:

(a) failures of the type covered by the procedures require greater censure than is currently given;

(b) they are not commensurate with the revenue or profit earned by the accountancy/audit firms or with the impact of the failures being sanctioned;

(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;

(d) they do not promote public confidence; or

(e) some other reason?

All of the above.

9. What are the key elements in achieving effective deterrence?

Penalties should be sufficiently onerous so as to incentivise entities to invest more into their review processes, both relative to the fine itself and also to the incremental insurance cost of professional indemnity cover, the cost of which presumably will rise in response to heavier penalties. Individuals should face both career risk and financial risk in the event of misconduct but the relative balance of these two factors should depend on the context of the individual's career.

10. Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

We believe that the UK has a reputation for robust accounting and high professional standards but these should be supported by appropriate sanctions for misconduct. Cases of misconduct often do not receive much publicity, but giving such cases a greater public profile might increase the deterrence value although any increased publicity should be balanced with giving more publicity for high quality work too.

11. Should there be greater use of non-financial sanctions such as:

(a) the imposition of of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or

(b) an order for some form of restitution?

All forms of sanction should be considered. Whilst restitution is available through the Courts where a loss has been experienced, the extended timeframe of the sanctions process means it is often too late for the outcome to contribute to the case for the plaintiff. An acceleration of the sanctions process so as to make the findings of an enquiry available to the Courts in a timely manner should be considered.

12. The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

(a) operating satisfactorily? or

(b) inappropriate, and, if so, why?

We have no view to express.

13. Are there some sanctions which could usefully be imposed which are not currently available?

We have no specific suggestions to make.

We hope this submission will make a constructive contribution to your review of Enforcement Procedure Sanctions but please feel free to contact us if you have any questions.

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29th June, 2017

FAO Noranne Griffith

Dear Noranne

As Invesco Perpetual's ("IP's") UK Equities Business Manager, I support IP's UK Equities Fund Managers with Matt Brazier on corporate finance and governance matters. As at the end of April 2017, IP had approximately £156 billion assets under management ("AUM"), of which the UK Equities Team manages approximately £28 billion, of which most investments are UK markets equity shares. Most of the team's funds are UK equity income funds, some are UK equity growth funds and some of these funds have just under £1 billion in total in private equity investments. In the context of providing UK Stewardship Code support to IP's UK Equities Fund Managers and their funds' investments, I write to provide our comments on your call for submissions on the FRC's Enforcement Procedures Sanctions. Our interest is in our funds' investments' reporting, auditing and governance regimes.

For our relatively small investment universe (in general just over 3,000 UK markets shares, of which we invest in between 200 to 300 at any one time), we believe strongly that the UK's company reporting, auditing and governance regimes are working effectively, despite the occasional and reasonably rare well publicised exception to this belief. As a result we think there is no need for major changes to the regimes and prefer the process of steady or evolutionary improvements to them from iterative resolutions of any issues arising. We do not believe in overly quick reactions to individual situations, especially if they may not be representative of regimes as a whole.

Question 1: Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory?

Underpinning our strongly held belief in the effective working of the UK's company reporting, auditing and governance regimes is not recollecting being affected significantly by any FRC sanction related situation. This also seems to be supported by your short schedule of sanctions imposed over the last eight and a half years under the Schemes in Appendix 3, none of which we experienced as investment managers as far as I can remember. As a result, we would answer your question yes, the objectives are satisfactory.

However, it seems out of place to mention that the primary purpose of imposing sanctions is not to punish; unless, a purpose or objective of imposing sanctions is to punish. Some of the available sanctions mentioned in Appendix 1 and imposed as set out in Appendix 3, such as fines or financial penalties, also suggest punishment rather than the other objectives. It is always difficult not to over react to wrong doing and feel a resulting need to punish severely; as opposed to righting a wrong or injustice and if that is not possible trying to prevent it happening again. We would suggest the objectives should therefore just refer to them and make no reference to punishment.

It would be interesting to know, for the same period as Appendix 3, how long the list of enforcement cases that did not result in any sanctions is, to see if these would also suggest that the objectives are satisfactory.

Question 2: Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Yes, as we are not aware of anything that would suggest otherwise.

Question 3

The available sanctions listed in Appendix 1 seem appropriate. As indicated in Question 1, the four main sanctions related objectives listed in Appendix 2 appear satisfactory. If any guidance were to be formed, it may be helpful to indicate which available sanctions would be appropriate for each sanctions related objective – for example reprimands, exclusions, bans and prohibitions could be linked to the deterrence and/or protecting the public objectives.

If it has not already been done, the Review Panel may want to consider undertaking root cause analysis of the enforcement cases that resulted in sanctions (as listed in Appendix 3) to see which sanctions related objectives have been affected and whether the resulting sanctions were appropriate in the context of the breached objectives.

Question 4: In imposing sanctions should decision makers seek to place any particular focus on entities rather than individuals or vice versa?

Decision Makers should impose sanctions on individuals rather than entities. It is usually individuals that are ultimately responsible for any wrong doing requiring sanctions. Focusing on entities will result potentially in other individuals or stakeholders, who are not responsible for the enforcement case being brought, being adversely impacted by the sanctions.

Question 5: In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

The starting point should be the incentives for individuals to stay on the right side of the sanctions related objectives in Appendix 2. For most people this would be not losing their good reputation, professional qualification and ability to do their job for a reasonably long time. Therefore the sanctions that remove one or more of these should be sufficient. If a financial penalty were felt to be appropriate it should be any earnings related to the misconduct, for example audit fees, or an amount that may contribute to rectifying the financial damage caused by the misconduct.

Question 6: To what extent do current sanctions meet regulatory objectives?

See question 3 and other comments above – we believe that current sanctions meet regulatory objectives.

Question 7: In relation to financial penalties are they being set at the right level? And Question 8

We do not have sufficient detailed or contextual knowledge to know whether financial penalties are set at the right level. We believe they should be a last resort and if imposed (see Question 5) should be calculable from related audit fees earned and therefore waived or repaid and from related financial losses caused (if any causal link can be made).

Question 9: What are the key elements in achieving effective deterrence?

The main element is loss of professional status or reputation.

The other elements are timely identification of issues and timely decisions on resolution of those issues. My understanding is that timely resolution of FRC enforcement cases is difficult due to deferring to other bodies, such as the SFO, FCA, PRA, ICAEW, etc, before being able to investigate and impose sanctions. Therefore, it may be helpful to publicise

regular updates on delays in the FRC enforcement process to enhance the deterrent effect of peoples' reputations being kept in the public eye.

Question 10: Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

Good behaviour is usually self imposed and public confidence is usually ensured by experience. Our limited experience suggests the accounting and auditing regimes including their enforcement in the UK are working effectively.

Question 11: Should there be greater use of non-financial sanctions?

The list in Appendix 3 suggests that there is a reasonable balance between the use of non financial and financial sanctions in the last eight and a half years. Our preference is the use of more non financial sanctions as they are perceived by us as being more likely to ensure the sanctions related objectives set out in Appendix 2.

Question 12

I do not have sufficient knowledge or experience to answer this question.

Question 13: Are there some sanctions which could usefully be imposed which are not currently available?

While not explicitly listed in Appendix 1, you refer to the non financial sanction of requiring further training in question 11. If this is not currently available, it should be.

In submitting our answers to your questions, we conclude:

- The reasons for imposing sanctions appear to us to remain appropriate
- The range of sanctions available appears fair and there are no reasons to think that they are ineffective
- More emphasis should be made on non financial sanctions
- More emphasis should be made on individuals rather than entities.

If you need to discuss any of our points above in more detail or you need clarification, please call me.

Kind regards, Charles

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Our Ref: RYDH/JAWH
Your Ref:
30 June 2017

Ms Noranne Griffith
Secretary to the Review Panel
Financial Reporting Council
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BY EMAIL ONLY

Dear Ms Griffith

Submissions to the independent review of the Financial Reporting Council's Enforcement Procedures Sanctions ("the Review")

Thank you for your letter dated 1 June 2017 inviting us to make submissions in relation to the Review; we are pleased to contribute and hope our submissions are of use to the Review Panel. In line with the Panel's instructions, we have limited our response to the matters with which we are most concerned rather than formulating responses to each of the 13 questions set out in the call for submissions. Where relevant, we refer to specific questions below and references to "questions" are made accordingly. We restrict ourselves to commenting specifically on the Sanctions Guidance under the Accountancy Scheme, but note that our submissions (especially those relating to deterrence and fines) are also relevant to the Sanctions Policy under the Audit Enforcement Procedure.

Deterrence

1. We consider the objectives set out in the Sanctions Guidance (and Sanctions Policy) to be, in the main, suitable and appropriate when considered as part of the Accountancy Scheme and the overriding aims of that enforcement procedure. It is clearly right that sanctions should be imposed, as stated in paragraph 9 of the Sanctions Guidance, in order to protect the public from misconduct, to maintain confidence in the accountancy profession and to uphold the proper standards of conduct. The following comments are restricted to the express aim of the sanctions "to deter members of the accountancy profession from committing 'Misconduct' ". We note the definition of "Misconduct" under the Accountancy Scheme:

> *Misconduct means an act or omission or series of acts or omissions, by a member or Member Firm in the course of his or its professional activities [...] or otherwise, which falls significantly short of the standards reasonable to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the member or the Member Firm or to the accountancy profession.*

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2. It is clear from the terms of this definition, as well as from investigations conducted by the FRC, that Misconduct includes inadvertent or honest mistakes made by Members and/or Member Firms, including mistakes made where third parties were deliberately misleading Members and/or Member Firms. We note that one of the factors for a Tribunal to assess as listed at paragraph 18 of the Sanctions Guidance is "*where the Misconduct involved a failure to comply with professional standards, whether such failure was intentional or unintentional.*" We suggest that further guidance on the inclusion of deterrence against future inadvertent Misconduct as an objective should be included within the Sanctions Guidance. As regards the specific sanction of fines, there is a danger in our view that deterrence is used as a basis to justify higher fines without sufficient consideration being given to whether the objectives identified in the Sanctions Guidance will be achieved.

3. Where sanctions are imposed for Misconduct of a reckless, dishonest or deliberate nature, or where lack of integrity is present, the relevance of deterrence as an objective is obvious. Where misconduct is inadvertent however, the justification for, and appropriateness of a sanction or fine set at a level to "deter" should be examined. In our experience, Members as professionals act in accordance with their professional duties and obligations and are not motivated to act in a manner which breaches those duties. Where they are negligent they know that they face exposure to civil liability, and exposure to financial penalties may follow. In our view further consideration (and guidance) needs to be given as to whether an objective of particular sanctions should be to deter members or Member Firms from inadvertent errors when deterrence in such circumstances is neither appropriate or effective. In the case of fines, they may be imposed quite properly to achieve other objectives of the Scheme, but as a form of deterrence there are other more effective measures. In our view (and relevant to questions 10 and 11) the imposition of compulsory training, quality assurance measures, regulatory inspections, mentoring schemes or other similar measures and/or sanctions is more likely to protect the public by reducing the risk of future inadvertent Misconduct and more likely than fines to promote accountancy work of a higher quality. Indeed, we question whether it is logical to seek to deter inadvertent mistakes through the imposition of fines, since inadvertent misconduct by its very nature lacks any conscious element of wrongdoing.

4. For these reasons, we consider that greater distinction ought to be made within the Sanctions Guidance between those sanctions which ought generally to be imposed for inadvertent mistakes (which might include, depending on the gravity of the mistake, Preclusions/Exclusions, Conditions and Reprimands) and those applicable to Misconduct involving an element of conscious wrongdoing (which would, in our view, properly encompass Fines in addition to other sanctions).

Fines

5. In relation to fines generally, we consider that some form of tariff would certainly improve the Sanctions Guidance by providing clarity and a degree of predictability. We also consider a tariff would promote earlier settlement in some cases. We note that a tariff would be consistent with paragraph 5 of the Sanctions Guidance, which provides that the document is intended to "*promote proportionality, clarity, consistency and transparency in decision-making and to ensure that all parties are aware from the outset of the approach likely to be taken by a Tribunal when determining what sanction to impose.*" It is our view that the tariffs set out in

the ICAEW Guidance on Sanctions do provide (as envisaged by questions 2 and 3) a useful model for tariffs that could be contained within the Sanctions Guidance.

Costs

6. Paragraph 9(10) of the Accountancy Scheme provides that a Disciplinary Tribunal's discretion to award costs to a Member or Member Firm "*shall be restricted to circumstances were the Tribunal finds that no reasonable person would have delivered or pursued all or a substantial part of a Formal Complaint under the terms of this Scheme*". This is evidently a high hurdle for Members and Member Firms to clear before being awarded any part of their costs; it does not impose, for instance, the ordinary presumption found in civil proceedings that "the loser pays", and allows the FRC to argue that even in the event of a Tribunal finding that no alleged Misconduct has been committed, the Member or Member Firm should bear their own costs.

7. The regime should discourage allegations which lack merit and also encourage Respondents to make admissions where appropriate to do so. In civil proceedings this is recognised, and under CPR Part 36 costs consequences flow from offers which should have been accepted. In our view costs, their impact and the influence they undoubtedly have on the behaviour of parties should be recognised in the same way that they are in civil proceedings.

8. It is our view that a more equitable costs regime would promote the objectives of the Accountancy Scheme and Sanctions Guidance by reducing the likelihood of allegations being made that do not have a realistic prospect of succeeding. An investigation by the FRC is likely to involve matters of considerable complexity and will therefore often be extremely costly for the Member and Member Firm under investigation. The regulatory process should allow a Tribunal unfettered discretion to recognise fairly the financial impact of costs on those under investigation or who become defendants in disciplinary proceedings. This would also allow the fair administration of justice in such proceedings.

Impact of investigations on Members and Member Firms

9. In connection with the matters set out in the section above, we observe that for Members and Member Firms under investigation, the impact of an investigation is significant and often severe in its own right, quite apart from any sanctions that may be imposed by a Tribunal. In our experience, individuals and firms take investigations extremely seriously and are required to (and do) devote substantial resources to complying with their obligations under the Scheme, which entails a time and financial cost.

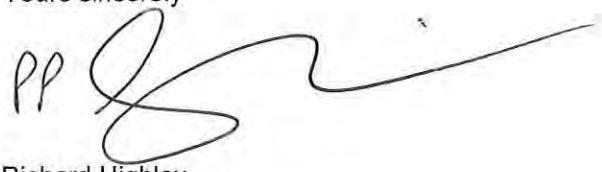
10. Paragraph 12 of the Sanctions Guidance contains guidance to the effect that a Tribunal should have regard to principles of proportionality in imposing sanctions, including by reference to the circumstances of the case. Such guidance is consistent with (in the specific instance of Fines) the guidance at paragraph 32, in which particular factors to consider in setting the level of a fine are set out, and more generally (as regards determining the potential sanctions to impose) at paragraph 18. It is our view that a further factor should be expressly listed within the factors to be considered (acknowledging that the guidance states that the Tribunal should also consider other factors, not listed, that may be relevant). Expressly identifying a factor will inevitably make a Tribunal more likely to consider it: that further factor, in our view, should be the length/cost/impact of the investigation on the Respondents in question. This is a point distinct from the consideration quite properly given by Tribunals (and

often referred to in decisions) to the co-operation of a Respondent, which is rightly treated as a mitigating factor. Instead, this proposed factor is one which takes into account the impact on Respondents (both individuals and firms) in being involved in investigations in the first place, which is an unquestionably punitive experience in its own right. We acknowledge that this is something frequently taken into account by Tribunals (especially in relation to individuals) and consider that explicit guidance to this effect would be helpful.

Admissions and settlement

11. Under paragraphs 57-61 of the Sanctions Guidance, admissions are encouraged with discounts applied to fines where settlement is achieved at earlier stages of the investigation or disciplinary proceedings. Under paragraph 60, an adjustment to reflect a settlement at the higher end of the discount range is deemed only appropriate where there are admissions of "substantially all the heads of complaint of the Formal Complaint". We question the appropriateness of this guidance, which does not appear to reflect the possibility that the heads of complaint may vary in gravity or merit. Where there are admissions of all those heads of complaint with merit, logically, a discount at the higher end of the range should be appropriate.

Yours sincerely



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For the attention of Noranne Griffith

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BY EMAIL AND POST

enforcementproceduressanctionsreview@frc.org.uk

Date
30 June 2017

Our reference
AVH/SVF

Your reference

Dear Sirs

Independent Review of the Financial Reporting Council's Enforcement Procedures Sanctions ("the Review")

1. Introduction

1.1 We welcome the opportunity to make submissions in relation to the Review and to comment on the appropriateness of the current sanctions guidance and the effectiveness of the range of sanctions available under the Accountancy Scheme and the AEP[1].

1.2 Taylor Wessing LLP has considerable experience of acting for the accountancy profession (both for Member Firms and Members) in relation to litigation and regulatory issues. Our team's experience includes acting on a significant number of past and present FRC investigations and proceedings. We also acted on a number of cases under the predecessor regimes, the JDS and AADB.

1.3 The Scheme and the AEP have different sanctions guidance - the Sanctions Guidance (June 2014) for the Scheme and the Sanctions Policy (June 2016) for the AEP. As the principles underpinning the Sanctions Guidance and the Sanctions Policy are broadly similar, we do not distinguish between them in these submissions. We refer to the Sanctions Guidance and the Sanctions Policy together as **"the Guidance"**.

1.4 Given that there have been no sanctions imposed under the AEP to date, our submissions are based on our experience of how sanctions have been implemented under the Scheme. We believe that similar considerations would be likely to apply to the AEP, subject to the point that the threshold for sanction is different under the AEP. The

[1] We do not make any submission insofar as the Actuarial Scheme is concerned as we do not have direct experience of disciplinary proceedings under that Scheme.

AEP provides for sanction for breach of a "Relevant Requirement", which is a lower threshold than "Misconduct" under the Scheme, meaning of course that sanctions under the AEP need to address a wider range of conduct than those under the Scheme.

1.5 We set out below some introductory comments and an overview of our submissions, before commenting on the specific questions raised in the Review consultation document.

2. The Guidance

2.1 The stated purpose of sanctions under the Scheme and the AEP is not to punish but to protect the public and the wider public interest.

2.2 The Guidance states that it seeks to achieve that objective by helping the Tribunal/Decision Makers to impose sanctions which achieve a number of objectives, namely:

(a) To deter members of the accountancy profession from committing Misconduct or a breach of a Relevant Requirement.

(b) To protect the public from Members and Member Firms whose conduct has fallen significantly short and from Statutory Auditors/Audit Firms whose conduct has fallen short of the Relevant Requirements.

(c) To maintain and promote public and market confidence in the accountancy profession and the quality of corporate reporting/statutory Auditors/Audit Firms and the quality of their audits.

(d) To declare and uphold proper standards of conduct amongst Members and Member Firms and Statutory Auditors/Audit Firms.

2.3 Those aims – to promote and maintain the highest standards within the profession, and to deter conduct which falls short of those standards – seem to us appropriate.

2.4 Our principal concern is that the apparent drive towards larger fines levied against accountancy firms and individual practitioners will not improve standards across the profession, and is not required as an effective deterrent against sub-standard work. It risks the opposite effect, discouraging firms and individuals from an involvement in challenging assurance work.

2.5 It is also very difficult for Member Firms and Members to predict the likely amount of any financial sanction at Tribunal. This risks inconsistency, a lack of fairness and means that cases are more difficult to settle (as respondents, and the FRC, cannot judge a reasonable offer). That would seem to us best addressed through the setting of guidelines (but not a fixed tariff) on sanctions in different categories of case.

3. The policy of sanctions

Deterrence

3.1 The primary purpose of imposing sanctions under the Scheme and the AEP is not to punish the Member Firm or Member[2], but to protect the public and the wider public interest. That seems to us to be appropriate for a professional disciplinary scheme.

3.2 We agree that deterrence should be part of that objective. We question however whether very large fines levied against Member Firms and Members are necessary to achieve this aim.

3.3 Some conduct which is subject to FRC disciplinary proceedings will involve deliberate wrongdoing. In our experience, this will often involve executives, or members in business, who fail to make proper disclosure to the auditors. Those cases plainly require there to be scope to increase penalties to deter such behaviour. This however seems to us to be adequately addressed in principle in the present Guidance by treating deliberate misbehaviour as an aggravating factor (albeit that we consider any sanction setting guidelines should provide a clear distinction in the level of the sanction to reflect dishonesty).

3.4 The FRC disciplinary matters on which we are instructed generally concern issues regarding the quality of the work that has been undertaken (most often audit). If there is an issue, then it will tend to have arisen through an honest mistake. Such cases will fall far short of "*bringing discredit on the profession*"[3], and will not involve questions of integrity. The AEP regime extends to breach of a Relevant Requirement, which is a lower threshold than Misconduct under the Scheme, and so will potentially encompass more minor alleged errors.

3.5 It is impossible to deter (by high fines or otherwise) an individual from making an inadvertent mistake. We recognise that the regulatory regime may (and should) incentivise firms to devote adequate resources to improving the quality of financial reporting. It seems to us however that raising the level of fines (at the same time as lowering the threshold for an error which might attract a fine) is unlikely to achieve this, and may in fact lead to the opposite result.

3.6 Most regulatory cases in our experience relate to audit (the AEP relates solely to audit of course). Audit is – to our understanding - a challenging area of operation for the large accountancy firms. It is, quite properly, subject to very significant regulation. It exposes the firms to unlimited civil liabilities as there is no practical mechanism by which auditors' liabilities to their clients can be limited.

3.7 These factors (together with the reputational damage caused by any large claim or disciplinary process) provide very significant incentives in themselves to audit firms and individual practitioners to seek to avoid error. We do not consider that this is an area in which audit firms have to be deterred from misconduct through the threat of increased financial sanction.

3.8 On the other hand, this is an area of practice (if the wider aim of improving the quality of financial reporting is to be achieved) which needs to be attractive to the most talented members of the profession. At present, a new audit partner faces:

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[2] In contrast, for instance, to the FCA regime which does have a punitive purpose.
[3] The second limb of the Misconduct definition under the Scheme.

(a) The (unavoidable) risk of unlimited civil liability.

(b) The possibility of disciplinary proceedings in relation to any falling short of a relevant requirement in which he or she is likely to be named personally as a respondent.

(c) The risk that such proceedings may effectively end (or at least blight) his or her career prematurely. While a disciplinary process is on foot (a process which can last several years[4]), a partner's ability to pitch for new business, or indeed to continue existing audit work, is often severely constrained.

3.9 It seems likely that any area of practice facing these pressures will struggle to attract the best candidates. A significant increase in the level of sanctions can only make this choice less attractive. It will also further erode the profitability of audit as a service line which may also in the long term tend adversely to affect the quality of professionals who choose to work in this area.

3.10 None of this is to say that regulatory oversight should be anything other than rigorous. The continuous and timely monitoring of audit work through the AQR process seems to us (albeit from limited experience) to work well: to be effective in driving improvements in audit quality, and deterring poor standards.

3.11 A focus on such ongoing oversight, and the promotion of best practice in "real time", would appear to us to be far more effective at raising standards within the profession (and hence protecting the public and the wider public interest) than a drive for increased sanctions in relation to historic cases.

Public and market confidence

3.12 We understand that any regulator needs to be seen to be robust. It is also clear that the uninformed, including sections of the press, may well consider that an auditor caught up in a corporate scandal should carry heavy responsibility for the costs of a corporate collapse or the dishonesty of management.

3.13 We are concerned however that the public and media call for more severe sanction against auditors (if that is indeed the case) is born from a misunderstanding of the nature of the audit process. An audit report is not designed to (and cannot) underwrite the financial fortunes of a business. Sanctions need fairly to reflect the inherent limitations of the process.

3.14 Comparisons are often drawn (by the media, and the FRC itself) with the levels of sanctions imposed on financial institutions by their regulators (such as the FCA or SEC). Those do not seem to us appropriate comparators; one of the objectives of the FCA sanctions is punitive which is not a feature of the Scheme or the AEP. First, the fines levied against financial institutions very often reflect the fact that such businesses have profited substantially from the alleged misconduct (say, market rigging or mis-selling allegations). Second, such cases very often involve serious questions of lack of integrity. Neither factor, in our experience, is a feature of the vast majority of FRC professional disciplinary proceedings.

[4] In *Connaught,* for example, the Tribunal hearing took place over 7 years after the events in question, and 6 years after the start of the investigation (paragraphs 73, 368). Other FRC cases (for example, *MG Rover*) have taken considerably longer.

3.15 We recognise that sanctions need to be seen to be meaningful in the right cases but we are concerned that the broader public interest in attracting and retaining talent in the audit and accountancy profession may be overlooked in favour of satisfying perceived public sentiment.

4. Predictability of sanctions

4.1 One can see from the helpful appendix to the Review consultation document the significant range in fines under the Scheme in recent years, and also the significant increase in recent awards.

4.2 The Tribunal report in *Aero* has not yet been made public. It is therefore not clear on what basis the Tribunal imposed a (then record) fine of £4 million in that case.

4.3 The Tribunal report for *Connaught*[5] has been published. We have however found it difficult to discern from that case report the principled basis upon which the sanction was calculated, such that it could be used as a reference point for future cases.

4.4 The Tribunal appeared to take two previous decisions into account in reaching its decision on sanctions (see paragraphs 330 to 336 of the Tribunal report). The first of these was the *JP Morgan* matter where the relevant work was not statutory audit; and the second was the *Aero* decision, in relation to which the Tribunal did not have the reasoned decision.

4.5 In *JP Morgan,* the Tribunal suggested a guideline for fines in future cases of Misconduct (on which we comment further below). In our view, the Guidance would be improved if it were now to include non-prescriptive guidelines for the setting of sanctions. That would lead to greater consistency and transparency of approach, and allow both the FRC and respondents better to gauge likely outcomes. It would also in our view assist in the early settlement of cases.

5. A different approach

New sanctions guidelines

5.1 We consider that the introduction of a "guidelines" system similar to (but perhaps less detailed than) that employed by the ICAEW would be appropriate for the FRC's enforcement procedures. Any system should not be prescriptive, but it should offer a guiding framework for Tribunals.

5.1 In our view, the present guidelines set out a comprehensive list of factors to be taken into consideration.

5.2 We would suggest that the additional factors set out below could usefully be included in the list of matters to be taken into account in assessing sanctions:

(a) A Member Firm's *current* record of audit quality (as opposed to historic conduct) – we consider that this would be a more meaningful metric than historic disciplinary matters.

(b) Old sanctions should not be taken into account after a certain period of time for the purposes of determining a sanction (say, 5 years). We consider that it would

[5] Taylor Wessing LLP acted for the Respondents in that case.

be unfair for Member Firms' penalties to be increased by reference to old prior cases.

(c) Size of audit fee. This can be a helpful indicator as to the seriousness, and significance, of the conduct in question.

5.3 We do not suggest significant changes beyond those below:

(a) The threshold for an adverse finding under the AEP - breach of a Relevant Requirement – is of course lower than the test for Misconduct under the Scheme (requiring something more than negligence to be established). We suggest three broad categories of sanctionable conduct which could then be used as a reference point for the guidelines on setting sanctions:

(i) minor error falling below the Misconduct threshold;

(ii) Misconduct (as defined in the Scheme); and

(iii) error or Misconduct which is deliberate or systematic or to which another aggravating factor applies.

(b) We suggest that guidelines are then produced with an indication of the range of likely sanctions (level of fine, reprimand, exclusion etc) which would be expected to be applied by a Tribunal in the event of an adverse finding.

(c) It would be helpful if the panel for the Review were able to produce draft guidelines and to seek further submissions in relation to the proposals. In that regard, the guidance offered by the Tribunal in *JP Morgan* is in our view a helpful guide, at least for Misconduct cases:

(i) at paragraph 36 the Tribunal stated, "*We have reached the conclusion that the starting point for the financial penalty in such cases should be the sum of £2 million*";

(ii) at paragraph 38 the Tribunal stated, "*We envisage that the penalty will be increased above the starting point by aggravating factors*"; and

(iii) at paragraph 39 the Tribunal concluded, "*We doubt whether such aggravating factors should take the penalty beyond the sum of £5 million, but we do not rule out exceptional cases where such a response is required.*"

(d) A range of £2-£5 million for the more serious Misconduct cases as anticipated by the Tribunal seems to us to be a not unreasonable starting point - taking account of a small inflationary increase - for the typical cases in that bracket. Cases of mere error, we would expect, would attract much lower financial fines and / or other non-financial sanctions.

(e) Any guidelines will be subject to adjustment (down in view of the respondent's resources or discounts for early settlement and up to cater for aggravating factors as set out in the Guidance).

6. Responses to Review questions

Question 1

6.1 We agree that the primary purpose of imposing sanctions should not be to punish the Member Firm or Member, but to protect the public and the wider public interest. In general, we have no issues with the objectives in the Guidance.

Question 2

6.2 We consider that the Guidance is appropriate subject to proper guidance as to the level of sanction, and the other proposed factors discussed in paragraph 5 above. There are also some areas of inconsistency between the Sanctions Guidance for the Scheme and the Sanctions Policy for the AEP that it would be sensible to ensure are addressed in any future iterations.

6.3 The guidelines should be sufficiently wide to cater for the broad range of issues which fall within the purview of the FRC and should, in our view, incorporate a guidelines system along the lines of that employed by the ICAEW.

Question 3

6.4 Please see our comments above.

Question 4

6.5 The threat of an adverse finding can have a severe (and often, in our view, excessive) personal impact on the careers of individuals involved.

6.6 If an adverse finding is later reached, the already existing impact – and the further impact of publicity – should reduce the need for additional sanctions (such as financial penalties or reprimands) to be placed against individual Members.

6.7 Cases involving lack of integrity on the part of individuals however should be addressed differently for the reasons explained above.

Question 5

6.8 Please see our comments above in relation to *JP Morgan*.

6.9 As noted above, we suggest that, if the panel for the Review is content to adopt a sanctions guidelines approach, draft guidelines are produced and further submissions sought in relation to the proposals.

6.10 That would encompass consideration of comparative sanctions under other professional disciplinary regimes in this jurisdiction and elsewhere; but not (as above) to the FCA or other financial regulatory bodies for which we consider different factors usually apply.

Question 6

6.11 Please see our comments above.

Question 7

6.12 Please see our comments above. We believe that the current financial penalties are too high.

6.13 In recent years, the fines imposed by Tribunals on Member Firms have increased markedly, without any clear explanation for the rationale for the increase.

6.14 The lack of a framework for financial penalties in the Guidance leaves open the possibility for arbitrary decisions in relation to financial penalties.

Question 8

6.15 We believe that the current (recent) financial penalties are too high, rather than too low.

Question 9

6.16 In our experience, it is the publicity associated with an adverse finding and the impact on an individual's career that acts as a deterrent rather than the financial penalty. We consider that there is already an effective level of deterrence.

Question 10

6.17 We do not believe that substantial financial penalties promote or incentivise good behaviour and promote public confidence. We recognise that financial penalties are likely to remain an important element of the sanctions regime, but their use, and level, should be closely controlled. If financial penalties continue to follow the current upward trend of materially increasing each year, there is a danger that Member Firms and Members may be discouraged from statutory audit work.

Question 11

6.18 We do not consider that a change is required to the Guidance in this respect.

Question 12

6.19 We believe that the current system on discounts for admissions and/or settlement operates satisfactorily.

6.20 One respect in which we believe the system could be improved to encourage early settlement is the introduction of an "offer system" – perhaps akin to a defendant's part 36 offer - which would enable respondents to enforcement proceedings to make without prejudice offers to the FRC to settle the proceedings.

6.21 In our experience, the FRC is less likely to engage in settlement discussions once a formal complaint has been served. If there were to be a system of offers which would provide respondents with some form of costs protection that may encourage a more proactive approach to settlement discussions.

Question 13

6.22 We do not believe that there are any sanctions currently not available which could be usefully imposed.

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, Andrew Howell (a.howell@taylorwessing.com), Julian Randall (jj.randall@taylorwessing.com) or Stephen Flaherty (s.flaherty@taylorwessing.com).

Yours faithfully

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29 June 2017

Ms N Griffith
Secretary to the Review Panel
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

By post and email: enforcementproceduressanctionsreview@frc.org.uk

Dear Ms Griffith

Independent review of Financial Reporting Council ('FRC') sanctions

Thank you for your letter of 1 June 2017 inviting our firm to contribute to the independent review of FRC sanctions.

Our responses to the questions raised in section 5 of the Review Panel's call for submissions are set out below.

Question 1: Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

1. Yes, although we think the FRC should be considering carefully what further purpose is served when another regulator has already disciplined one of its Members in relation to a particular set of events.

2. Where a number of regulators have an interest in disciplining a Member there is a need for co-ordinated action between those regulators and transparency with the Member about what each of those regulators' intentions are. There is a need for a move towards a "global" settlement process where a Member can negotiate and settle with all the concerned regulators within the same time frame before any settlement is reached with any one regulator. At present, other regulators force the pace of settlement within their own rules without reference to the FRC and its own procedures. We have developed this point further in our response to question 7 below.

Question 2: Is the Sanctions Guidance / Sanctions Policy satisfactory and fit for purpose in current circumstances? Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with: (a) guidance, either of the current or some other type; (b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or (c) some form of guideline which divides regulatory offences into categories and prescribes a range

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of penalties having regard to the aggravating and mitigating features of the offence within the category.

3. We think the Sanctions Guidance and Sanctions Policy are broadly satisfactory and fit for purpose in current circumstances. However, we believe that certain aspects could be improved, as set out in response to the questions below.

4. With regard to tariffs, we would recommend introducing a form of tariff along the lines of the Guidance on Sanctions of the ICAEW. This would provide Members and Member Firms with greater clarity over the potential sanctions if they engage in misconduct of a certain type. This would also assist the FRC in achieving its objectives of deterring Members and Member Firms from committing misconduct and of improving behaviour within the profession against consistent guidelines and/or existing precedents.

5. We would also recommend that when a person is appointed by the Conduct Committee under paragraph 8(4) of the Scheme, or the Tribunal is asked under paragraph 8(5) of the Scheme, to consider whether a proposed settlement agreement already agreed between the Executive Counsel and a Member is appropriate to be entered into, the relevant decision maker should be provided with all relevant correspondence and other documentation which explains the basis on which the proposed sanctions have been agreed, by reference to any guidance, tariffs and/or precedents as a matter of course.

6. Should that decision maker nevertheless want to depart from the proposed agreed sanctions then he/she should be required to invite further submissions from the Executive Counsel and the Member, having made clear his/her concerns with the proposed agreed sanctions.

7. Only after those further submissions have been considered, should the decision maker make a decision in relation to whether the proposed agreed sanctions are appropriate that is binding on both the Executive Counsel and the Member.

Question 3: In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

8. Please see the response to question 2 above.

Question 4: In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa? In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

9. The FRC should consider carefully whether any individuals should be investigated and then publicly named and shamed. Unlike entities, individuals are flesh and blood with dependants and individual associates who are also likely to be adversely affected by any FRC investigation and subsequent sanctions. Whether sanctions are appropriate for an entity and/or individuals should be assessed on a case-by-case basis depending on the particular facts.

10. When considering a case against an individual, decision makers should place particular focus on how long the investigation has been allowed to continue. The personal stresses and strains on any individual under any regulatory investigation should never be underestimated. The emphasis should

be on seeking to conclude any matter involving an individual as soon as possible. As entities are not flesh and blood, there are not the same concerns unless the entity is so personally connected with one or more individuals there is in effect no difference.

Question 5: In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

11. Yes. This will provide greater transparency to Members and Member Firms under investigation as to their potential liability for financial penalties at an early stage. It would also be likely to ensure greater consistency of financial penalties whether on a settled or contested basis.

12. We would recommend following a similar approach to that of the Financial Conduct Authority ('**FCA**') (see the FCA's Decision Procedure and Penalties Manual) and the Prudential Regulation Authority ('**PRA**') (see the PRA's Statement of the PRA's policy on the imposition and amount of financial penalties under the Financial Services and Market Act 2000 ('**FSMA**')) when calculating the starting point for financial penalties. Both the FCA and PRA calculate the starting point by reference to disgorgement (deprivation of any economic benefits derived directly from the misconduct) and a percentage (depending on the seriousness of the misconduct) of revenue/income over the relevant period of misconduct. We consider this may be a useful starting or reference point for the FRC to construct its own approach.

13. However, when setting the percentage to be applied to revenue/income for calculating the starting point for financial penalties, the FCA and PRA take different approaches. The FCA has five levels of seriousness, each with a set percentage ranging from 0% to 20% for firms and 0% to 40% for individuals. In comparison, the PRA has discretion to determine an appropriate seriousness percentage, with no cap on the percentage that could be applied to the relevant revenue/income.

14. In the interests of transparency and for Members and Member Firms to have an understanding of their potential liability for financial penalties at an early stage, we prefer the more formulaic approach of the FCA. We would therefore recommend that the FRC adopt fixed percentage levels based on levels of seriousness (with discretion at a later stage to reduce or increase the penalty based on other factors).

Question 6: To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

15. We think that current sanctions broadly meet regulatory objectives. However, we believe that certain aspects could be improved, as set out in this response, especially in relation to multi-regulatory actions against Members.

Question 7: In relation to financial penalties are they being set at the right level?

16. We have specific recommendations in respect of financial penalties in multiple regulator cases.

17. Enforcement action against Members by multiple regulators in relation to a particular set of events is likely to become more frequent in future years. Since 7 March 2017, the FCA's Conduct Rules have applied to all banking sector staff who are not performing purely administrative functions. This is likely to be extended to all FSMA authorised firms in 2018. Accordingly, by the end of 2018, a considerable number of Members working in the financial services sector are likely to be subject to the FCA's Conduct Rules. This will likely result in more multiple regulator cases involving the FCA/PRA and FRC in relation to Members. That is particularly likely given any adverse finding by

the FCA/PRA is conclusive evidence of misconduct under paragraph 16(3) of The Accountancy Scheme (the '**Scheme**').

18. Past practice indicates the FRC will usually await the conclusion of a FCA/PRA investigation before proceeding with its own sanctions proceedings, as it may rely on any adverse findings by the FCA/PRA as conclusive evidence of misconduct which require no further investigation and/or consideration by the FRC. While that increases efficiency from the perspective of the FRC, it runs the real risk of putting the relevant Member in a difficult situation as regards any early settlement with the FCA/PRA. On the one hand, a Member has a financial incentive of early settlement with the FCA/PRA. On the other hand, any adverse finding agreed by way of settlement will be conclusive evidence of misconduct under the Scheme, leaving the Member open to the possibility of an additional but unknown financial penalty from the FRC. It makes any settlement decision very difficult when seeking to quantify what the total final cost may be. The current position is invidious for the individual concerned and his/her advisers.

19. We would therefore recommend that the FRC consider how it might better cooperate with the FCA/PRA and Members in multiple regulator cases, so that global settlements can be considered. One possibility should be for the FRC to be willing to consider a settlement with a Member within the same timeframe as the FCA/PRA settlement process on the basis of adverse findings agreed on a without prejudice basis between the Member and the FCA/PRA. That would allow the Member to make an informed decision as to whether to settle with the FCA/PRA, with the benefit of knowing what sanctions he/she will face from the FRC if he/she decides to settle with another regulator.

20. We also recommend that the FRC consider carefully the appropriateness and proportionality of imposing an additional financial penalty in multiple regulator cases. We consider this an important issue in the interests of fairness towards Members and to prevent "piling on" (more frequently seen on a cross-border basis), where multiple regulators each impose substantial fines in respect of the same events. We do not think the current Sanctions Guidance is sufficiently mindful of this issue.

21. Paragraph 20 of the Sanctions Guidance sets out the general rule that the FRC must disregard sanctions imposed by other regulators when determining what sanction to impose. The FRC will therefore disregard whether the Member has been fined by another regulator when deciding whether a financial penalty is an appropriate sanction. However, this is displaced in respect of preclusions, as paragraph 43 states that other regulatory sanctions may be considered when determining whether preclusion is an appropriate sanction. We do not think this distinction is justified and we consider that there are good reasons for adopting the same approach as preclusions for financial penalties. We would therefore recommend that paragraph 20 of the Sanctions Guidance be reconsidered.

22. Once the FRC has decided that a financial penalty is appropriate, the current Sanctions Guidance is unclear as to the extent to which the FRC should take into account other regulatory penalties when determining the size of that financial penalty. On the one hand, paragraph 31 provides that the FRC should aim to impose a fine that is proportionate to the misconduct and "*all the circumstances of the case*". This would appear to include other financial penalties in respect of the same events. However, paragraph 20 appears to override that position, as it says that FRC will take account of other regulatory sanctions "***only*** *when considering a Member or Member Firm's financial position*" (our emphasis added) – i.e. the FRC will only consider whether a previous financial penalty has affected the Member's financial ability to pay an additional penalty.

23. We believe that paragraph 20 is too narrow in this respect. In order to prevent aggregate financial penalties being disproportionate to the relevant misconduct, we would recommend requiring the FRC to consider whether the aggregate amount of the penalties would be disproportionate to the

misconduct itself (i.e. even if the FRC's penalty taken on its own is proportionate and even if the Member has sufficient financial resources to pay it).

Question 8: If respondents think that financial penalties are too low is this because: (a) failures of the type covered by the procedures require greater censure than is currently given; (b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned; (c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards; (d) they do not promote public confidence; or (e) some other reason?

24. We do not think that financial penalties are too low generally.

Question 9: What are the key elements in achieving effective deterrence?

25. Transparency and clarity coupled with a co-ordinated approach with any other regulators concerned.

Question 10: Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

26. Yes, we believe that current sanctions promote and incentivise good behaviour and promote public confidence. However, as set out in response to question 11, we would recommend the greater use of non-financial sanctions, particularly in the case of Members to promote rehabilitation.

Question 11: Should there be greater use of non-financial sanctions such as: (a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or (b) an order for some form of restitution?

27. Yes, we would recommend the greater use of non-financial sanctions, such as those suggested in the question. In particular, in the case of Members, we would recommend the greater use of conditions (such as a direction to undertake education or training), where appropriate, to place more focus on rehabilitation as opposed to punishment.

Question 12: The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions: (a) operating satisfactorily; or (b) inappropriate, and, if so, why?

28. While the FRC's Disciplinary Tribunal (the '**Tribunal**') already has the discretion to adjust sanctions for admissions under paragraph 57 of the Sanctions Guidance even if the case proceeds to a hearing, we would recommend the introduction of a formal process for partly contested cases that provides certainty over discounts for early admissions and settlement. This would allow Members and Member Firms to agree certain elements of a case (e.g. facts and liability) and contest the other elements before the Tribunal, with certainty over the appropriate settlement discount to reflect the extent that issues have been settled and admissions made. We would recommend using the same percentage discounts in paragraph 59 of the Sanctions Guidance for when a Member or Member Firm agrees facts and liability at an early stage and only wishes to challenge the question of sanction:

    Stage (1) - the period from receipt by the Member or Member Firm of the decision to commence an investigation until the delivery of a Formal Complaint – a reduction of between 20 and 35%;

    Stage (2) - the period from delivery of a Formal Complaint until the commencement of the hearing of the Formal Complaint by the Tribunal – a reduction of up to 20%; and

Stage (3) - the period following the commencement of the hearing of the Formal Complaint by the Tribunal until the final conclusion of the case, including any appeals – no reduction.

Question 13: Are there some sanctions which could usefully be imposed which are not currently available?

29. While not a sanction against a Member or Member Firm, we would recommend that the FRC consider extending the powers of the Tribunal in respect of making a costs order against the FRC where the Tribunal dismisses a substantial part of a Formal Complaint. This was a recommendation of the Tribunal in its recent report in relation to the misconduct of PWC and Stephen Harrison dated 12 April 2017 (see paragraphs 357 and 358).

30. The Tribunal's power to make a costs order against the FRC is governed by paragraph of the Scheme. Paragraph 9(9) only provides the Tribunal to make a costs order against the FRC if it dismissed the entire Formal Complaint. Consequently, the Tribunal has no power to make a costs order against the FRC as long as one allegation succeeds, even if the vast majority of a Formal Complaint is dismissed. This applies irrespective of the amount of time and costs that relate to the dismissed allegations and irrespective of the reasonableness of the FRC in pursuing the dismissed allegations. This runs the real risk of producing very unjust results for Members and Member Firms.

31. We would therefore recommend that the Tribunal be empowered to make a costs award against the FRC where it dismisses all or a substantial part of a Formal Complaint and it finds that no reasonable person would have delivered or pursued those dismissed aspects of the Formal Complaint.

If you would like to discuss our response with us, please do not hesitate to contact Harvey Knight on 020 7597 6199 or at harvey.knight@withersworlwide.com and Philip Salvesen on 020 7597 6119 or at philip.salvesen@withersworldwide.com.

Yours faithfully

Withers LLP

Withers LLP

Association of Accounting Technicians response to the independent review of Financial Reporting Council standards: call for submissions

Association of Accounting Technicians response to the independent review of Financial Reporting Council standards: call for submissions

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1. Introduction

1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the independent review of Financial Reporting Council standards: call for submissions, published on 11 May 2017.

1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.

1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.

1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.

1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by AAT's 4,250 licensed accountants.

2. Executive summary

2.1. The objectives for the Sanctions guidance and policy are broadly in line with the principles of professional conduct operated by professional bodies
The guidance provided is useful but whilst it is essential that guidance like this provides clarity for those reliant on it, it must also be sufficiently flexible so as to ensure that it can be adapted and applied taking into account individual case circumstances
Given that there is a desire to influence behaviour and to promote public confidence there needs to be a raising of awareness around the Sanctions and the application of the policy in order to achieve those outcomes

3. AAT response to the consultation paper

3.1. The following paragraphs outline AAT's response to the questions posed in the consultation paper. We have only listed those questions where we have a comment to make.

3.2. Question 1
Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

Response: ***The objectives are satisfactory as they meet the primary purpose of imposing sanction for acts of 'Misconduct' which is to protect the public and the wider public interest. This is congruent with the general professional conduct principles of most professional bodies.***

3.3. Question 2
Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Response: ***While current guidance appears fit for purpose, should any amendments be made then further guidance for decision makers is crucial and a tariff might prove useful to them, although clarity should not equate to unnecessary rigidity.***

Guidelines for assessing categories of offences would be useful, perhaps covering areas including competence, honesty, effects on others, seriousness, and ongoing risk. In addition, historical information could help devise a table of more specific types of breaches and how they might be considered against those criteria. Once again, flexibility and the ability to take each case on its merits is fundamental.

3.4. Question 3
In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

Response: As detailed in the previous response, the inclusion of details pertaining to specific breaches based on historical information would be beneficial.

3.5. Question 4
In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

Response: ***The FRC's current focus encompasses both members and member firms and the range of sanction (in Appendix 1 and 3) appear to be proportionate deterrents that recognise that the issue(s) have arisen from the actions of the organisation and the action (or inaction where professional scepticism has not been applied) of the auditor that constitutes 'misconduct'.***

3.6. Question 5
In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

Response: ***No comments***

3.7. Question 6
To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

Response: ***The regulatory objectives are supported by having the full range of financial and non-financial sanctions available that are more likely to deter members of the accountancy profession from committing 'misconduct'. For example, a member or member firm may not change their behaviour by the application of a fine whereas, given the more substantive implications, they are likely to take exclusion rather more seriously.***

3.8. Question 7
In relation to financial penalties are they being set at the right level?

Response: ***No comments***

3.9. Question 8
If respondents think that financial penalties are too low is this because:
(a) failures of the type covered by the procedures require greater censure than is currently given;
(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;
(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;
(d) they do not promote public confidence; or
(e) some other reason?

Response: ***No comments***

3.10. Question 9
What are the key elements in achieving effective deterrence?

Response: ***The public nature of sanction reporting, and the reputational damage with the knock on effect on client recruitment and retention.***

Proportionality and perceived fairness are also key elements.

A further key element is whether or not the sanction changes the future behaviour of the member or member firm that has been sanctioned and the subsequent changes in the behaviour of others in terms of taking preventative measures in order to avoid being subjected to enforcement action.

3.11. Question 10
Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

Response: ***The current range of sanctions are likely to promote and incentivise good behaviour.***

The sanctions will only promote public confidence where the public are aware of it so more could, and should, be done to publicise the sanctions that have been applied.

3.12. Question 11
Should there be greater use of non-financial sanctions such as:
(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or
(b) an order for some form of restitution?

Response: ***This should not be an either / or question. All sanctions should be available in all cases and be appropriate and proportionate to the individual case.***

3.13. Question 12
The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance , as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:
(a) operating satisfactorily; or
(b) inappropriate, and, if so, why?

Response: ***There is an argument to be made that co-operation and honesty should be taken as read, rather than 'rewarded'. Instead, failure to co-operate or make admissions should attract more severe sanctions.***

3.14. Question 13
Are there some sanctions which could usefully be imposed which are not currently available?

Response: ***The current list of sanctions seems appropriate and very much in line with most professional bodies.***

4. About AAT

4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

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ACCIF
AUDIT COMMITTEE CHAIRS' INDEPENDENT FORUM

Noranne Griffith
Secretary
For and on behalf of the Review Panel
Financial Reporting Council
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Email to enforcementproceduresreview@frc.org.uk

Dear Sir/Madam

Independent review of the Financial Reporting Council's enforcement procedures sanctions

The Board of the Audit Committee Chairs' Independent Forum (ACCIF) is pleased to respond to the Review Panel's call for submissions in respect of the questions set out in section 5 of its paper. Our response addresses the Sanctions Guidance for the Accountancy Scheme and the Sanctions Policy for the Audit Enforcement Procedure only – we make no comment on the Actuarial Scheme Sanctions Guidance as we do not believe we are qualified to do so.

This response reflects the views of the Board of the ACCIF; it has not been possible for us to canvass the views of the wider ACCIF membership as the call for submissions was open only for seven weeks.

If you have any questions and / or would like to discuss this further, please contact us via the below email addresses.

Yours faithfully

pp. V Sinclair.

Jock Lennox

Chairman of the Audit Committee Chairs' Independent Forum

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Question 1: Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

1.1 The objectives are not entirely satisfactory. Some of the four objectives are quite strategic while others are highly tactical. It would be preferable to present a single strategic objective and, if necessary, then discuss how the more tactical objectives help to achieve that objective, rather than present them as objectives in their own right. It seems to us, for example, that the objective "to deter [members of the accountancy profession/Statutory Auditors and Statutory Audit Firms] from [committing Misconduct/breaching the Relevant Requirements]", is effectively subsumed by the other three objectives in paragraph 9 of the Sanctions Guidance for the Accountancy Scheme (SG) and paragraph 11 of the Sanctions Policy for the Audit Enforcement Procedure (SP). In our view, the overriding purpose that the sanctions are intended to achieve is to maintain and promote public and market confidence in the accountancy profession/statutory auditors and the quality of corporate reporting.

1.2 It is also a little odd that paragraph 9 of the SG and paragraph 12 of the SP should state that "the primary purpose of imposing sanctions ..... is not to punish, but to protect the public interest" when the first objective/purpose set out in paragraph 9 of the SG and paragraph 11 of the SP is "to deter [members of the accountancy profession/Statutory Auditors and Statutory Audit Firms] from [committing Misconduct/breaching the Relevant Requirements]", when deterrence may be defined as the use of punishment as a threat to deter people from offending.

Question 2: Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose?

2.1 It is clear that the SP (dated June 2016) was designed to replicate the SG to the maximum possible extent. The SP, however, is concerned only with breaches of regulatory requirements in relation to statutory audits, whereas the SG is concerned with misconduct in relation to any professional activities by Members (actuaries as well as accountants) or Member Firms, and some of the factors listed in paragraph 21 of the SP are unlikely to be of great, if any, relevance. For example, paragraph 21c) discusses in some detail the financial benefit derived by the Member concerned from the breach, implying that the auditor will often derive a direct financial benefit from a breach. In most enforcement cases involving auditors, however, the relevant touchstone is a failure to comply with Auditing Standards and there will be no direct link between the breach and the statutory auditor's remuneration. Similarly, in the case of auditors it will rarely be possible to establish a direct link between the breach and a loss or risk of loss of significant sums of money (this is one reason why we do not support the addition of orders for restitution to the sanctions available to the FRC – see our response to Question 11 below).

2.2 At the same time, the factors that are likely to be among the most important in most cases involve significant judgement, such as the gravity and the duration of the breach concerned, are not discussed in any detail in the guidance.

2.3 We suggest that the Review Panel discusses with those who have played the role described in the SP as "Decision Makers" in cases concerning statutory audits the factors that were considered in those cases, as a basis for improving the usefulness of paragraph 21 of the SP.

2.4 It seems to us anomalous that in respect of statutory audits the maximum duration of the temporary prohibitions set out in paragraph 16 of the SP is three years whereas no such time limit is placed on similar prohibitions in paragraph 16 of the SG. In extreme cases of audit failure a period in excess of three years might be appropriate. However, we appreciate that the three year maximum is specified in the European Audit Directive.

2.5 Having regard to the numerous factors that might be relevant in specific cases, such as the importance of the requirements or standards breached, the degree of responsibility and financial strength of the individual and firm concerned, we doubt whether a useful and reliable detailed tariff or categorisation of offences and range of penalties could be prepared. However, it is appropriate for the public, accountants and accountancy firms to be aware of the sanctions that the FRC would likely apply in cases of the most serious misconduct or breach of requirements. In this regard, it seems to us extremely unlikely that the FRC would ever exercise its power to prohibit one of the large accountancy firms from carrying out statutory audits or other activity based on an individual case and in any event such a prohibition would be extremely disruptive to the market for the services concerned.

2.6 In order to reassure individuals and firms who are subject to the Accountancy Scheme and the Audit Enforcement Procedure that the sanctions imposed will always be fair and reasonable, we consider it very important to retain the statement in paragraph 5 of both the SP and SG that "this document is intended to promote proportionality, clarity, consistency and transparency in decision-making", and to retain the statement at para 7 of the SP and para 6 of the SG that "nothing in this guidance is intended to be inconsistent with the Audit Enforcement Procedure/provisions of the Accountancy Scheme and Decision Makers/Tribunals must proceed in accordance with the overriding requirements of fairness and natural justice". We emphasise the need to retain these statements since, so far as are aware, no similar statements appear either in the European Audit Directive 2014/56/EU or in the Statutory Auditor and Third Country Auditor Regulations 2016.

Question 3: If respondents think some form of tariff or detailed guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

3.1 As stated in paragraph 2.5 above, we doubt whether a useful and reliable detailed tariff or guideline could be prepared but we consider that the FRC should publish some information about the extent of the sanctions it would be likely to apply in cases of the most serious misconduct or breach of requirements.

Question 4: In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

4.1 We believe that in the case of all professions, the primary focus for decision-makers in imposing sanctions should be on individuals. In the case of statutory audit, this is consistent with the requirement for audit reports to be signed by the senior statutory auditor. However, we also believe that sanctions should be imposed on firms as necessary to reflect their responsibility for managing and directing the work of individuals employed by the firm, in order to act as a credible deterrent.

4.2 To express a view on whether either entities are currently dealt with too harshly compared with individuals or vice versa it would be necessary to have detailed knowledge of the circumstances of the cases listed in Appendix 3 to the call for submissions. We would, however, offer some overall observations on this question. The reputation damage caused to an individual by a reprimand or exclusion is likely to be severe, whereas a reprimand in an individual case is unlikely to damage significantly the reputation of a large accountancy firm and therefore a credible deterrent for such a firm is likely to take the form of a significant fine. However, since the cases that have resulted in sanctions against accountancy firms since 2009 number less than 20, during which period the number of audits carried out runs into many thousands in the case of listed companies alone, there is no evidence that increases in sanctions against accountancy firms are required in order to strengthen deterrence.

Question 5: In relation to financial penalties, should the FRC establish some starting point in respect of both individuals and entities?

5.1 We do not see any merit in establishing a starting point for financial penalties under a regime in which the financial penalties are not determined solely on the basis of the severity of the breach or misconduct but also take account of factors specific to the individuals and entities that are penalised. As noted in paragraph 3.1 above, however, there would be some deterrent value in indicating publicly the extent of the sanctions the FRC would be likely to apply in cases of the most serious misconduct or breach of requirements.

Question 6: To what extent do current sanctions meet regulatory objectives?

6.1 The suite of sanctions available to the FRC is broad and appears to be comprehensive, and combines measures designed to prevent recurrence through the improvement of behaviour as well as punishment *pour encourager les autres*. With regard to the way in which the sanctions have been applied, it appears that the severity of the sanctions applied in the last few years has increased. We believe that at the current level of severity, the sanctions applied have an appropriate deterrent effect and that further increases in the severity of sanctions are not required for this purpose. Again, it is necessary to keep in mind that the number of cases in which sanctions against individuals and entities have been applied is very low relative to the total population to which the Accountancy Scheme and the Audit Enforcement Procedure apply.

Question 7: In relation to financial penalties, are they being set at the right level?

7.1 Without knowing the extent of the financial resources of individuals against whom financial penalties have been ordered, it is not possible to assess whether such penalties are being set at the right level as regards individuals. We would observe, however, that in the case of individuals, the non-financial sanctions, in particular prohibitions but also reprimands, are likely to have a highly negative effect on their reputation and hence employability and are therefore likely to have a greater deterrent effect than financial penalties. On this basis, we doubt whether an increase in the level of financial penalties that have been ordered against individuals in the recent past would result increase the deterrent value of the financial penalty.

7.2 Non-financial sanctions are likely to be less appropriate in the case of larger accountancy firms as we are not aware of any evidence suggesting that the misconduct or breaches concerned in cases in which the larger firms have been sanctioned is symptomatic of organisation-wide misconduct or breach of requirements. As a consequence, financial penalties need to be sufficiently significant in relation to the firm concerned to ensure that proper oversight and management of employee behaviours is reinforced. From a practical viewpoint, the financial penalty needs to be sufficiently significant to cause concern in the firm about its reputation, which in turn probably means the penalty needs to be sufficiently significant to attract media attention. It seems to us that the financial penalties imposed on accountancy firms in the recent past have achieved these objectives and therefore that no increase in the level of such penalties is necessary at this time.

Question 8: If respondents think that financial penalties are too low, is this because .....?

8.1 As explained in response to question 7, we do not believe that financial penalties imposed on individuals or entities are too low.

Question 9: What are the key elements in achieving deterrence?

9.1 We assume that the Review Panel intends this question to relate to regulatory sanctions only, even though they of themselves play only an extremely minor role in deterring misconduct or breaches of requirements by accountants and auditors. We say this because it seems to us that the nature and extent of any regulatory sanctions that are required to achieve deterrence must depend on the integrity and professionalism of accountants and auditors and the quality of embedded policies and procedures in accountancy firms. In our experience, and also as reflected in the small number of cases that have resulted in sanctions being imposed on accountants and accounting firms, the professional standards of UK accountants and accounting firms are generally high.

9.2 Nevertheless, we believe that regulatory sanctions are necessary as a backstop to deter misconduct and to maintain and promote public confidence in the accountancy profession and the quality of auditing and financial reporting. We have discussed above in response to questions 6 and 7 those sanctions that we regard as having the greatest deterrent effect as regards individual accountants and auditors on the one hand and as regards accountancy firms on the other.

Question 10: Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

10.1 There is no doubt that current sanctions do incentivise good behaviour and promote public confidence. The key issue is whether they do so in sufficient measure. This is purely a matter of judgement but as we have explained in response to questions 6 to 8 above in particular, we do not believe that any additional sanctions or any increase in the severity of the sanctions that have been imposed in recent years are necessary and doubt whether they would of themselves result in improved behaviours or increased public confidence.

10.2 In fact, based on our substantial personal experience as audit committee chairs, we are concerned that the current regulatory regime overall, through its focus on process rather than conclusions and outcomes, and its intrusiveness, is making auditing a less attractive career for able and insightful professionals compared with other opportunities and there is a danger that we have embarked on a downward spiral whereby greater regulation drives out more quality resources, which results in greater regulation, and so on.

Question 11: Should there be greater use of non-financial sanctions such as:

(a) The imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or
(b) An order for some form of restitution?

11.1 As we have noted in paragraph 2.5 above, the exclusion of one of the larger accountancy firms from practice in a particular area would cause significant market disruption. In any event we cannot see any justification for the imposition of conditions on or exclusion from practice in the case of firms as a result of an individual case where there is no significant evidence of systemic breach of requirements or misconduct. In this regard we note that since 2009 not only have there been less than 20 cases in which accountancy firms were sanctioned, as compared with the many thousands of audits that they have carried out in that period, but also that in these cases sanctions have been imposed on eight larger firms and the highest number of cases in which sanctions have been imposed on the same firm is two.

11.2 There is clearly greater justification for imposing conditions on or excluding from practice individual practitioners who have committed misconduct or a breach of requirements, or imposing requirements for further training. However, the imposition of conditions or of requirements for further training would be appropriate only in cases involving misconduct or breaches that were not of major significance in terms, for example, of the result of the misconduct or breach or the extent of the negligence or recklessness involved. It would appear from the schedule of cases in Appendix 3 to the call for submission that in none of the cases could the misconduct or breaches involved be considered not to be of major significance. This would suggest that if the FRC were to make greater use of non-financial sanctions such as the imposition of conditions or exclusion from practice on individual practitioners it would be necessary for it to seek out and address what would in all probability be a much larger casebook, which would greatly increase the cost of the FRC's enforcement activities. In our view, such an expansion of the scope of the FRC's enforcement activities is not required in order to meet the objectives of the Audit Enforcement Procedure and Accountancy Scheme as set out in paragraph 11 of the SP and paragraph 9 of the SG, and would therefore not be cost effective.

11.3 With regard to exclusion, we note that the sanction of exclusion has to date been imposed on company accountants in a number of cases – for periods of up to 10 years - but has been imposed on an auditor in only one case, for a period of three years (which may be because it is the maximum period specified in the SP). In the case of misconduct by company accountants, it is likely that such factors as intent, financial benefit and the length of time involved would be important factors in the decision to impose exclusion, and it is unlikely that such factors would apply or be significant in the case of statutory auditors who are considered to be liable for enforcement action. However, where failings by an auditor arise in relation to more than one annual audit as a result of significant and widespread lack of professional competence and due care in the performance of the audits, in our view the practitioner should be excluded from practice. We are unable to express a view on whether this would result in greater use of the exclusion sanction in the future than in the past, as this would require detailed knowledge of past cases that we do not have, and we would emphasise that exclusion should be imposed only in the most egregious cases.

11.4 In our view it would not be appropriate for the FRC to have the power to order any form of restitution. Restitution orders should be left to the courts in civil law cases relating to professional misconduct. In many cases there would also be very significant practical difficulties in measuring any loss which restitution would be intended to recompense and respondents might fairly argue that they should be able to challenge any order for restitution through legal process. Orders for restitution would be likely to increase substantially the cost of the enforcement process and the time required to deal with cases (which is already far too long).

Question 12: The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement. Are these provisions:

(a) Operating satisfactorily; or
(b) Inappropriate, and, if so, why?

12.1 We are not in a position to know whether the provisions relating to discount for admissions and/or settlement are operating satisfactorily

12.2 We do not believe that the use of discounts to expedite proceedings in disciplinary matters is inappropriate. It would, however, be inappropriate if the discounts were so large as to tempt respondents to admit to the regulator's charges rather than defend themselves against the charges where the regulator's case was not overwhelmingly strong. This risk is likely to be greater in the case of individuals, in particular company accountants who are not supported by the resources of a firm as is the normally case with auditors.

Ms N Griffith
Secretary to the Independent Review Panel
The Financial Reporting Council

By email: n.griffith@frc.org.uk

Date 30 June 2017
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Our ref RR
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Dear Noranne

Independent review of Financial Reporting Council (FRC) Sanctions

Thank you for your letter of 25 May 2017 inviting my response to the Review Panel's call for submissions for the purposes of its current review of FRC Sanctions.

I should preface my comments by noting that, in my role as Convener and as Secretary to FRC Disciplinary Tribunals, I do not participate in the deliberations or decision-making of the tribunals in FRC cases and the comments below represent solely my own views. My comments are informed by my experience of the sanctioning powers of other regulators for whom I act as a legal assessor, or otherwise advise in other professional regulatory sectors, such as health. I have only commented on those questions where I think I am able to offer some input in relation to the principles of regulatory sanctioning, rather than those concerning the outcomes of FRC Tribunal cases.

Question 1
Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

The objectives at paragraph 9 of the Sanctions Guidance appear consistent the legal principles established in regulatory case law authorities and with the objectives in the sanctions guidance of other professionals regulatory bodies of which I have experience. These objectives reflect the well-known and established "three limb" definition of public interest.

I have only two further points which might supplement paragraph 9: first, as reflected in some regulators' guidance, that public confidence in the ***regulation*** of the profession, as well as in the profession itself, is a proper objective of sanctions.

Secondly, as stated in the final paragraph, the primary purpose of regulatory sanctions is not punishment. Nevertheless, the appropriate sanction which achieves the public interest objective may have a punitive effect. A sanction such as suspension could be appropriate as a marker of the gravity of the "offence", even where there is strong mitigation, good insight and a low risk of

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repetition, because recognition of the public interest requires the imposition of more serious sanction.

Question 2
Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:
(a) guidance, either of the current or some other type;
(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or
(c) some form of guideline which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.

In my view the Sanctions Guidance is fit for purpose. However, in my experience, disciplinary panels are anxious about how they can ensure consistency of sanctions between cases. This is particularly the case in relation to the imposition of financial penalties. It is well understood, and reflected in case law, that in the nature of disciplinary cases, each one is different and must be assessed on its own facts, circumstances and merits and it is not possible or desirable to try to impose consistency. I am aware that some regulators whose sanctions guidance used to include a tariff or "entry points" have now moved away from that to a more principles-based approach.

Consistency between cases could be enhanced by tribunals having available a formal record of the findings in previous cases, as long as the record included a reasonable level of information about the cases, including the allegations.

Question 3
In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

Please see comments under Question 2.

Question 4
In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?
In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

My comment is that in the case of individuals, mitigating factors are often much more influential than in the case of an entity which could contribute to any perception that individuals are dealt with more lightly than entities. This is particularly so where the case has a long history: the

individual's circumstances may be very different by the time a case comes to a hearing. The individual may, for example, have retired from practice and the impact of the proceedings hanging over the individual for a long period of time is likely to weigh significantly in their favour in mitigation. Further, although individual professionals must be held personally accountable for their actions within an entity, their actions are frequently revealed by the disciplinary process to be part of a bigger picture of wider, systemic failings within the entity.

Question 5
In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?
If respondents think that the FRC should establish some starting point, they are invited to articulate;
(a) how they consider that starting point should be measured for entities or individuals (e.g. by reference to specified monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);
(b) how the starting point should be determined; and
(c) what criterion/a should produce what starting point(s).

I believe more detailed guidance about the appropriate basis for assessing financial penalties would be desirable and would aid tribunals in achieving consistency as far as possible.

Question 6
To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

I think they do if effectively applied.

Question 7
In relation to financial penalties are they being set at the right level?
In answer to this question, respondents are invited to state;
(a) whether they think they are too low or too high, and
(b) by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.

___

Question 8
If respondents think that financial penalties are too low is this because:
(a) failures of the type covered by the procedures require greater censure than is currently given;
(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;
(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;
(d) they do not promote public confidence; or

(e) some other reason?

___

Question 9
What are the key elements in achieving effective deterrence?

___

Question 10
Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

___

Question 11
Should there be greater use of non-financial sanctions such as:
(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or
(b) an order for some form of restitution?

There is not an established practice of using such orders in the FRC tribunals, whereas conditions of practice orders are regularly used in health and other tribunals. In suitable cases, such orders have the potential to be effective measures for protecting the public whilst the individual/entity returns to safe and competent practice.

Question 12
The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance2, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:
(a) operating satisfactorily; or
(b) inappropriate, and, if so, why?

___

Question 13
Are there some sanctions which could usefully be imposed which are not currently available?

The health regulators have powers to review both suspension and conditions of practice orders at resumed hearings and to vary those orders upon the application of the parties or where the tribunal considers it appropriate: for example, variance from a conditions order up to suspension, or vice versa, or to vary the content or duration of a conditions order. These sanctions can then be used flexibly and effectively to monitor compliance and protect the public if circumstances so demand.

Further, the health tribunals are able, when imposing a conditions of practice or suspension order, to direct that there will be a review hearing before the order expires. This has the benefit of ensuring that progress/compliance with the tribunal's order is assessed, rather than the individual simply being able to return automatically to unrestricted practice upon the expiry of the tribunal's original order.

I hope these few comments are of some interest in the Independent Review Panel's deliberations.

Yours sincerely

Rosemary Rollason
Convener and Secretary for the FRC Disciplinary Tribunal

Submission to the Independent review of Financial Reporting Council sanctions

The following submission has been prepared by Rahul Rose, a senior researcher at London-based NGO Corruption Watch.

More details about Corruption Watch can be found here: http://www.cw-uk.org/the-team-2/

This submission relates only to the Accountancy Scheme and the AEP, and not the Actuarial Scheme.

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

Question 2

Is the Sanctions Guidance/Sanctions Policy[1] satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:

. **(a) guidance, either of the current or some other type;**

Both the AEP Sanctions Policy and the Accountancy Scheme Sanctions Guidance list cooperation as a mitigating factor that can result in reduced financial penalties. However, in both guidance documents no information is given on what constitutes good cooperation, and what level of fine reduction will be given to cooperating companies/individuals.

This reduces the incentive to cooperate with FRC investigations because: a) it is unknown what the benefit of cooperating will be and b) it is unclear what exactly counts as cooperative behaviour.

Considering the FRC's low number of investigations/cases (see answer to question 9), more guidance on cooperation would be welcome if it encourages companies and individuals to come forward and self-report allegations of misconduct in the hope of earning a reduced sanction. The UK Serious Fraud Office (SFO) has developed

(through public speeches[1] by senior officials and guidance documents[2]) a clear cooperation regime that offers some form of penalty reduction in return for significant, pro-active cooperation, which rises above mere compliance with coercive measures - the key element of which is self-reporting misconduct to authorities.

. **(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or**

The ICAEW Guidance on Sanctions uses starting points that are too low. The FRC should be weary of adopting guidance similar to the ICAEW's.

In particular, the ICAEW's starting point for a number of audit-related categories of misconduct is the audit fee. Relying solely on audit fee as a starting point for FRC corporate financial penalties would lead to inappropriately low fines for several reasons:

- *Audit fees are often very low compared to the importance of the service being provided*

  Certain auditors are reducing the quality and thoroughness of their services in an attempt to stay competitive by charging very low audit fees. In its 2012 Audit Quality Inspection[3] annual report, the FRC said there had been "substantial reductions" in audit fees for a number of audit tenders for big listed companies. The report said that auditors, in a bid to reduce the cost of their services, were engaging in cost-cutting exercises that reduce audit quality, such as a reduction in sample sizes tested, greater delegation to junior staff, reduced training and increased use of checklists. The 2013 Audit Quality Inspection annual report repeated these concerns, and highlighted the potential risks of audit firms "offshoring" procedures to low-cost economies, such as India, in an attempt to save money[4].

  Low-cost audits that sacrifice on quality contribute to a higher risk of misconduct. They are the very kind of audit that will likely come before the tribunal.

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[1] https://www.sfo.gov.uk/2015/05/20/compliance-and-cooperation/
[2] https://www.sfo.gov.uk/publications/guidance-policy-and-protocols/corporate-self-reporting/
[3] https://www.frc.org.uk/Our-Work/Publications/AIU/Audit-Quality-Inspections-Annual-Report-2011-12.aspx page 8
[4] https://frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Inspections-Annual-Report-2012-13.pdf page 8

- *Relying on audit fees solely as a starting point fails to take into account the consultancy and advisory work that auditors do for clients.*

  Audit fees often make up only a part of the financial relationship between a client and their auditor, with non-audit fees making a significant contribution. The dependence of Big 4 firms on non-audit fees is an area of concern. The Treasury Select Committee said during the financial crisis: "[T]hat, as economic agents, audit firms will face strong incentives to temper critical opinions of accounts prepared by executive boards, if there is a perceived risk that non-audit work could be jeopardised."[5]

  A number of FRC enforcement cases involve auditors charging large non-audit fees. MG Rover collapsed in 2005 with nearly £1.4 billion in debts despite receiving a clean bill of health from Deloitte. Between 2000 and 2005, Deloitte earned £28.8m in non-audit fees from the MG Rover Group compared to only £1.9 related to audits[6]. Likewise, PwC, which is under investigation for its auditing of BHS, since 2009 collected £2.28 million in audit fees and £9.04 million in consultancy fees from Taveta Investments Limited, which is the ultimate parent of BHS[7].

  EU audit legislation, which became effective in 2016, mandates that consultancy fees paid by a public interest entity to an auditor can be no greater than 70 per cent of the audit fee[8]. This will likely lead to a decrease in the amount of consultancy work done by firms for large-company audit clients.

  However, it remains the case that using the audit fee as a starting point without considering lucrative consultancy arrangements - which are sometimes implicated in allegations of misconduct and may have been won as a result the firm's longstanding audit work for the client - will lead to inappropriately small financial penalties.

Question 3

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5 https://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/519.pdf page 83

6 https://www.frc.org.uk/FRC-Documents/FRC/FRC-Progress-Report-MG-Rover-Group-Companies-Act-I.aspx page 4

7 https://www.researchgate.net/publication/312847412_The_UK_Financial_Reporting_Council_can't_investigate_BHS_audits

8 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.158.01.0077.01.ENG

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

See answer to question 5

Question 4

In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

Individuals AND corporates should both, equally be the focus of FRC sanctions and enforcement. The FRC should not place a particular emphasis on one or the other.

The FRC when pursuing companies has generally also brought cases against senior individuals, such as partners and directors, for related misconduct. There is one exception to this – PwC's £1.4 million fine in 2011 for "very serious" misconduct during its audit of JPMorgan Securities[9]. The tribunal deciding this case expressed "surprise and concern" that no PwC partner was named by the FRC. The case raised serious questions over whether PwC secretly agreed with the FRC to admit wrongdoing in exchange for protecting the identity of the relevant partner(s).

The AEP Sanctions Policy and the Accountancy Scheme Sanctions Guidance should be updated to expressly advise against deals that protect individuals in exchange for a corporate admission of guilt.

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

In the context of corporate wrongdoing, a good starting point for the FRC is the amount of revenue generated by the business unit during the period in which the misconduct/breach of a relevant requirement occurred. If the misconduct was a one-off event, then the revenue will be calculated for the 12 months preceding the end of the misconduct. By starting with the revenue of the relevant business unit, rather than audit fee as is the case in the ICAEW system, the FRC will be able to ensure higher levels of financial penalties. As discussed in the answer to questions 7,

[9] https://www.frc.org.uk/FRC-Documents/AADB/Decision.pdf

FRC fines are currently too low.

The FRC should adopt the Financial Conduct Authority's (FCA) system of calculating the financial penalty by applying a percentage to revenue[10]. The more serious the breach (taking into account factors such as whether it was deliberate and whether it a large impact), the higher the percentage applied.

Once a figure is reached by applying a percentage to revenue of the relevant business unit, the FRC should, as in the FCA system, adjust the size of the fine to take into account aggravating and mitigating factors. The factors currently set out in the FRC's Accountancy Scheme Sanctions Guidance and AEP Sanctions Policy are satisfactory.

As in the current FCA and FRC system, the financial penalty should then be adjusted to take ensure deterrence and reflect admissions/early disposal.

The FCA system of applying a percentage to revenue led to a significant increase in fines after it was adopted in March 2010. By 2011 the FCA (and its predecessor) had imposed a total of just £66 million in fines, but in 2014 alone the regulator levied nearly £1.5 billion in financial penalties.[11]

It should be noted that step 1 of the FCA system, where disgorgement is calculated, has limited applicability to accounting and auditing regulation where it is often difficult to determine the profit gained or loss avoided.

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

The current sanctions regime is failing to maintain and promote public and market confidence in the accountancy and audit professions. Ensuring confidence in the two professions is one of the core regulatory objectives set out in the Accountancy Scheme Sanctions Guidance and the AEP Sanctions Policy.

The FRC has faced criticism from many parts of UK society, including the banking sector, academia, politics and the media, for lax enforcement, and low-level fines, that have failed to hold accountants and auditors to account for serious wrongdoing.

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[10] https://www.handbook.fca.org.uk/handbook/DEPP/6/5A.pdf
[11] http://globalinvestigationsreview.com/insight/the-practitioner%E2%80%99s-guide-to-global-investigations/1079347/fines-disgorgement-injunctions-disbarment-the-uk-perspective

Criticism from financial journalist has been severe. Following the FRC's decision in August 2016 to impose a £2.3 million fine on PwC over its 2007 audit of Cattles, the Financial Times' city editor Jonathan Guthrie complained that "feeble fines mean the Big Four are not being held to account"[12]. Guthrie also described PwC's £1.4 million fine for its auditing of JPMorgan Securities "disgracefully small", especially for a case that "underpins the credibility" of the profession[13]. The Independent's chief business commentator welcomed this current review of sanctions, describing the FRC as a "blind snail with a broken leg"[14].

There is also concern in some parts of the finance sector that the FRC is a light-touch enforcer that is unable to adequately sanction accounting misconduct. Analysts at Citigroup have described the FRC as a "toothless regulator" which lacks resources[15].

However, examining the FRC sanctions regime in isolation, as this review does, can only provide a partial explanation for the lack of public confidence in accounting regulation. Too many serious allegations of misconduct are not being properly investigated by the FRC, let alone sanctioned, and this is especially true of potential audit and accounting wrongdoing linked to the financial crisis of 2008. Professor Prem Sikka at the University of Essex has been particularly vocal about the FRC's failings on this front. In 2013 he wrote the FRC's reputation as an accounting watchdog has been "severely battered" by its lack of investigations into audit and accounting practices in the run up to the financial crisis[16].

Since Sikka's comments were made, the FRC announced an investigation in June 2016 into KPMG's auditing of HBOS[17]. However, the investigation, which was announced some eight years after the bank's collapse, only came following intense public pressure. Prior to June 2016, then-Treasury Select Committee chair Andrew Tyrie had repeatedly called for the FRC to investigate KPMG. In December 2015, he said: even if the FRC is confident it won't find evidence of misconduct, a thorough investigation is needed to "maintain public confidence in bank auditing".

The FRC's handling of the HBOS case has also provoked criticism from academics and

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[12] https://www.ft.com/content/6bafa112-6f84-11e6-9ac1-1055824ca907?mhq5j=e3
[13] https://www.ft.com/content/a3f0c736-379e-11e1-a5e0-00144feabdc0?mhq5j=e3
[14] http://www.independent.co.uk/news/business/comment/is-it-a-bird-is-it-a-plane-no-its-accountancy-watchdog-the-frc-being-proactive-for-a-change-a7658701.html
[15] https://www.ft.com/content/c32eb8e6-37d5-11e2-8edf-00144feabdc0?mhq5j=e1
[16] http://theconversation.com/mg-rover-debacle-cant-hide-accounting-regulation-failures-18075
[17] https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2016/June/Investigation-into-KPMG-Audit-plc%E2%80%99s-audit-of-HBOS.aspx

specialists, including former Bank of England regulator Iain Cornish who said the FRC suffered from a "lack of curiosity"[18].

The FRC's response to the financial crisis, and its handling of the HBOS affair in particular, has damaged the reputation of the regulator, and raises questions about its ability to meet its regulatory objectives, including maintaining public confidence, deterring misconduct and protecting the public.

The insufficient response of the FRC to the financial crisis is perhaps also a contributing factor to the continuing lack of quality in bank and building society audits. In May 2014, at the time of the publication of the Audit Quality Inspections Annual Report, Paul George, the executive director of the FRC's conduct division, said: "We have not seen enough progress in the quality of bank and building society audits which continues to be generally below that of other types of entities." In particular, FRC inspections found that some auditors were insufficiently testing the provisions that banks had been making against possible losses against loans.[19]

Question 7

In relation to financial penalties are they being set at the right level?

In answer to this question, respondents are invited to state;

- **(a) whether they think they are too low or too high, and**
- **(b) by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.**

Despite improvement in recent years, fines are still significantly lower than they should be.

Prior to 2013, the FRC had a very poor record, imposing only a few, generally low level fines (see appendix 1, table 1). Between 2009 and 2012, the FRC imposed £1.65 million in fines, the bulk of this figure coming from a £1.4 million penalty imposed on PwC for its audit of JPMorgan Securitas. During this period, the average fine imposed on an individual was only £9,000. In fact, in two years, 2010 and 2012, no fines were imposed on either companies or individuals.

Since 2013, there has been a general upwards trend (minus some small fluctuations) in the size of penalties being imposed (see appendix 1, table 1). Between 2013 and

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18 https://www.publications.parliament.uk/pa/cm201617/cmselect/cmtreasy/582/58208.htm#_idTextAnchor059

19 https://frc.org.uk/News-and-Events/FRC-Press/Press/2014/May-2014/FRC-publishes-Audit-Quality-Inspections-Annual-Rep.aspx

2016, the average fine imposed on individuals increased 116 per cent from £32,500 to £68,025. For corporate penalties the upward trend has been even greater. In the same period, the mean corporate fine increased 186 per cent from £750,000 to £2,146,667.

The number of fines has also been on a general upward trend since 2013. Only three fines were imposed in 2013, while in 2017, 10 have been imposed so far (more than in any preceding year) with an average corporate fine of £3,637,500, and a mean individual fine of £81,500.

However, fines remain too low for both individuals and firms when the remuneration/revenue of those being disciplined is taken into account. Financial penalties tend to be only a small fraction of the revenue/remuneration of the firms and individuals facing disciplinary action. There is a real danger that financial penalties will come to be seen simply as a cost of doing business, too low to deter future misconduct.

The disparity between the size of the financial penalty and revenue/remuneration is very pronounced in cases involving Big 4 firms (see appendix 1, table 2). In 2013, the average fine imposed on an individual from a Big 4 firm was just 7 per cent of the mean profit per UK-based partner at a Big 4 firm. This figure increased only slightly to 10 per cent in 2015 and 16 per cent in 2016[20]. Such low percentages casts doubt on whether the FRC is following its own sanctions guidance and "eliminat[ing] the financial gain or benefit" of misconduct[21].

The Accountancy Scheme's Sanctions Guidance states that: "a Member's remuneration is likely to be an appropriate starting point when considering the level of Fine." One wonders whether this guidance is being followed in practice when fines are so negligible compared to remuneration.

It should be noted that the mean profit per UK-based partner at a Big 4 firm, which has stayed around £700,000 for the last few years, is a pre-tax figure. Even so, individuals from Big 4 firms facing FRC fines tend to be partners, and so will have had many prior years of employment earning hundreds of thousands of pounds per annum, allowing them, in all likelihood, to have accrued substantial savings and assets. It seems probable that FRC fines at current levels would constitute a very small fraction of these assets and savings.

Mean corporate fines against Big 4 firms are also insubstantial when compared to the average revenue of the Big 4's UK operations (see appendix 1, table 2). In 2013, the mean corporate fine against a Big 4 firm was just 0.03 per cent of their mean UK

[20] No individual from a Big 4 firm was fined in 2014.

[21] Both the Accountancy Scheme Sanctions Guidance and the AEP Sanctions Policy instruct decision makers/tribunals to impose sanctions that "eliminate any financial gain or benefit" derived as a result of a breach of relevant requirements/misconduct.

revenue. This figure rose negligibly to 0.04 per cent in 2015, and 0.12 per cent in 2016. It would be even smaller if compared to the mean global revenue of the Big 4, which is more than ten times the average revenue of the UK arms.

Corporate fines are also often only a fraction of the audit and non-audit fees gained. For example, between 2000 and 2005, Deloitte earned £30.7 million audit and non-audit fees from the MG Rover Group, but only faced a £3 million fine[22]. When there is such a wide disparity between the size of the fine and the fees earned, the FRC becomes open to the criticism of being a light-touch regulator that is failing to eliminate the financial benefits of accounting/auditing misconduct[23].

FRC fines are also small when compared to those imposed by the FCA. The sum of the FCA's (and its predecessor the FSA's) financial penalties has consistently dwarfed the amount levied by the FRC. See table below:

	2011	2012	2013	2014	2015	2016	2017
FCA/FSA (Fines in millions of £)	66	312	474	1,471	905	22	163
FRC (Fines in millions of £)	0	1.64	0.82	1.04	4.69	6.71	7.93

It should be noted that there are differences between the size of the accounting and banking sector, and that there differences between the profits and revenues of major banks and large accountancy firms - but these are small when compared to the disparity in the size of the fines. For example, HSBC's revenue in 2016 was US$48 billion compared to US$36 billion for PwC.

There are also differences in the types of misconduct sanctioned by the FRC and FCA. A number of auditors that Corruption Watch spoke to in preparation for this submission, pointed out that FCA cases, such as the libor and forex manipulation cases (which are responsible for the spike in FCA financial penalties levied in 2014) often involve misconduct that is deliberate and intentional. They also pointed out that deliberate wrongdoing is often not present in FRC cases. However, this distinction should not be overblown – there are numerous examples of trained accountants engaging in deliberate misconduct (see answer to question 9). In addition, the FCA also often heavily sanctions wrongdoing that does not involve

[22] https://www.frc.org.uk/FRC-Documents/FRC/FRC-Progress-Report-MG-Rover-Group-Companies-Act-I.aspx page 4

[23] Both the Accountancy Scheme Sanctions Guidance and the AEP Sanctions Policy instruct decision makers/tribunals to impose sanctions that "eliminate any financial gain or benefit" derived as a result of a breach of relevant requirements/misconduct.

intentional wrongdoing. An example of this is the FCA's recent £163 million Deutsche Bank fine for failing to maintain adequate anti-money laundering controls[24].

Audit and accounting regulation is no less important than financial markets regulation. As the US Supreme Court noted in *United States v. Arthur Young*, auditors perform a vital "public watchdog" function[25]. Public confidence in financial markets is dependant on auditors providing fair and objective reports to shareholders and potential investors. Misconduct by auditors and accountants is every bit as damaging to financial markets as wrongdoing by the staff of financial services firms regulated by the FCA. It follows that there should be more parity between the financial sanctions imposed by the FRC and the FCA.

Question 8

If respondents think that financial penalties are too low is this because:

- **(a) failures of the type covered by the procedures require greater censure than is currently given;**
- **(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;**
- **(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;**

(d) they do not promote public confidence; or

(e) some other reason?

See answer to question 7 for explanation of why financial penalties are insufficient, and question 6 for a discussion of whether they promote public confidence.

Question 9

What are the key elements in achieving effective deterrence?

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[24] https://www.fca.org.uk/news/press-releases/fca-fines-deutsche-bank-163-million-anti-money-laundering-controls-failure Interestingly, the FCA determined that Deutsche Bank only gained £9.1 million in commissions from failing to block suspicious trades, but the fine that the regulator imposed was many times this figure.

[25] https://supreme.justia.com/cases/federal/us/465/805/case.html

The following discusses key elements of effective deterrence for the audit/accountancy industry:

Intention

One often-repeated argument is that misconduct by accountants/auditors is distinct from misconduct by bankers: the former usually involves an error and is unintentional, while misconduct in the banking sector usually involves intentional risk taking for financial benefit. Therefore some say the threat of a financial sanction has limited deterrent effect for accountants/auditors as they are not actively and intentionally seeking to commit a regulatory breach, but only do so in error.

This argument is questionable given the much cited example of Arthur Andersen, and the fact that the FRC has taken enforcement action on numerous occasions against trained accountants who have been engaged dishonest and deliberate misconduct, such as iSoft's former financial controller Ian Storey[26] and the former CFO of Healthcare Locums[27] Diane Jarvis.

Further, financial sanctions deter misconduct even if it takes the form of an unintentional accounting or auditing error. If firms face the prospect of significant fines for errors, they are likely to invest in improved training and compliance procedures, while the possibility of large financial penalties for individual accountants/auditors will also ensure enhanced diligence on an individual level.

Adverse publicity

In the audit sector, the lack of competition for lucrative big-company audits blunts the effectiveness of publicity as a deterrent. The Big Four - PwC, Deloitte, EY and KPMG - handle 98 per cent of FTSE 350 audits[28]. The dominant position of the Big Four is cemented by their size, allowing them to take on larger, more complex audits than their smaller competitors. Even the smallest of the Big 4 has three times the audit revenue of the largest second-tier firm[29].

In cases involving Big 4 firms, it is questionable how effective enforcement tools that

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[26] https://www.frc.org.uk/Our-Work/Publications/Professional-Discipline/Report-of-the-Disciplinary-Tribunal-Mr-Ian-Storey.pdf

[27] https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/July/Outcome-of-disciplinary-case-against-Ms-Diane-Jar.aspx

[28] https://www.ft.com/content/268637f6-15c8-11e6-9d98-00386a18e39d?mhq5j=e3

[29] https://www.publications.parliament.uk/pa/ld201011/ldselect/ldeconaf/119/11905.htm

rely on adverse publicity (such as reprimands) are unless they are used in conjunction with other sanctions.

The probability of apprehension

Academic research in a different context, examining tax misconduct and criminal sanctions, has found that a key part of deterrence is the likelihood of being caught. Professor Daniel Nagin at Carnegie Mellon University has written extensively about the fact that the severity of a sanction has a minimal deterrent effect if there is only a small probability of apprehension[30]. So, for the FRC to provide a credible deterrence, it needs to be detecting, investigating and sanctioning a significant proportion of the accounting and audit misconduct that affects the public interest.

While the number of enforcement cases that the FRC concludes each year is on a general upward trend, the total figure remains too small. Between 2009 and present, only 23 investigations have resulted in a sanction against an individual and/or company. In comparison, the Financial Conduct Authority (FCA) secured 151 outcomes using its enforcement powers in 2015/16 alone[31].

Between 2009 and present, the FRC also dropped seven investigations without pursuing any sanctions. The FRC has also failed to sanction any company over misconduct linked to the financial crisis of 2008.

Separately, it is important to stress that the FRC not only brings too few investigations, but when it does launch a formal inquiry, it will often be inadequate. Investigations often proceed at a slow pace. For example, the FRC announced an investigation into Deloitte's auditing of Aero Inventory in March 2011[32], but a sanctioning decision was not reached till over five years later in October 2016. Similarly, an investigation into Deloitte's auditing of MG Rover Group was announced in August 2005[33], but a sanctioning decision came some ten years later in

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[30] http://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-projects-and-surveys/economic-crimes/20001012-symposium/cPlenaryI.pdf p22 - p23

https://pdfs.semanticscholar.org/cdec/d97f9e20c12a23a862afc17ffed4129cc55c.pdf

[31] https://www.fca.org.uk/enforcement-annual-performance-account-2015-16/14-enforcement-statistics

[32] https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2011/March/AADB-announces-investigation-in-connection-with-Ae.aspx

[33] https://www.frc.org.uk/FRC-Documents/FRC/FRC-Progress-Report-MG-Rover-Group-Companies-Act-I.aspx

2015.

Investigations are also often very limited in their scope only looking at a short time period. The ongoing BHS and HBOS investigations are only examining potential misconduct over a one-year period, even though there is evidence that possible wrongdoing occurred over a longer time frame. As a result potential wrongdoing may not be detected, or at least properly investigated. Further, sanctions, if imposed, may be too low as misconduct will appear to have occurred during a short, isolated period.

The FRC also often seems reluctant to launch investigations unless there is a public scandal or external pressure, or both. This suggests that the FRC may have limited intelligence resources. Examples of investigations launched following public scandal, or inquiries by another authority, such as the SFO, include: Serco, BHS, Tesco, Rolls-Royce, BAE Systems, BT Group, HBOS, Lehman Brothers and The Co-operative Bank. Indeed, often investigations are launched such a longtime after the initial alleged misconduct, and proceed so slowly, that they are abandoned because the case has become too old. In the BAE case, the FRC dropped its investigation of KPMG in 2013 because there was "no realistic prospect that a Tribunal will make an adverse finding in respect of a complaint relating to work done so long ago."[34]

Corruption Watch has found that the FRC has a lack of appetite for investigations into the auditing of companies that pay bribes. So far the regulator has not sanctioned a single professional accountant working within a corrupt company or external auditor of a corrupt company. A judicial review challenge brought by Cornerhouse and the Campaign Against Arms Trade in 2013 criticised the FRC for dropping its investigation into KPMG's BAE audits despite strong evidence pointing towards possible wrongdoing[35]. For example, KPMG signed off on BAE's accounts despite full and detailed reports in the Guardian from December 2003 onwards about corrupt payments by BAE to Saudi Arabian officials. The misconduct detailed in the reports formed the basis of BAE's 2010 guilty plea and US$400 million fine in the US[36].

Unless the FRC undertakes more investigative and intelligence work, it will be unable to effectively deter accounting/auditing misconduct as the probability of wrongdoing being detected, let alone sanctioned, is too low.

The low volume of FRC investigations is in part down to the regulator's limited

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[34] https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/August/Closure-of-investigation-into-the-conduct-of-KPMG.aspx

[35] https://www.caat.org.uk/resources/companies/bae-systems/2013-08-08-frc.pdf

[36] https://www.justice.gov/opa/pr/bae-systems-plc-pleads-guilty-and-ordered-pay-400-million-criminal-fine

resources. According to the FRC's 2016 annual report, the enforcement division only has only 24 employees[37]. This is small compared to the FCA, which has over 650 full-time employees in its enforcement and market oversight division[38].

Question 10

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

See answer to question 6 for a discussion of why current sanctions do not promote public confidence.

[37] https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-Annual-Report-and-Accounts-2015-16.pdf page 16
[38] https://www.fca.org.uk/publication/corporate/annual-report-2015-16.pdf page 106

Appendix 1

Table 1: FRC fines between 2009 and present

Year		No. of fines	Total fine (£)	Mean fine (£)
2009	individual	2	12,000	6,000
	corporate	0	0	0
	total	2	12,000	6,000
2010	individual	0	0	0
	corporate	0	0	0
	total	0	0	0
2011	individual	1	15,000	15,000
	corporate	2	1,625,000	812,500
	total	3	1,640,000	546,666
2012	individual	0	0	0
	corporate	0	0	0
	total	0	0	0
2013	individual	2	65,000	32,500
	corporate	1	750,000	750,000
	total	3	815,000	271,667
2014	individual	2	63,000	31,500
	corporate	2	975,000	487,500
	total	4	1,038,000	259,500
2015	individual	5	323,000	64,600
	corporate	4	4,365,000	1,091,250
	total	9	4,688,000	520,889
2016	individual	4	272,100	68,025
	corporate	3	6,440,000	2,146,667
	total	7	6,712,100	958,871
2017	individual	8	652,000	81,500
	corporate	2	7,275,000	3,637,500
	total	10	7,927,000	792,700

Table 2: comparing mean FRC fines with Big 4 UK revenue and partner profits

Year		No. of fines	**Total fine (£)**	**Mean fine (£)**	***Mean Big 4 UK revenue/ partner profit share (£)***	***Mean fine as % of mean revenue***
2013	individual	1	50,000	50,000	712,000	7
	corporate	1	750,000	750,000	2.1862 billion	0.03
2014	individual	0	-	-	729,000	-
	corporate	0	-	-	2.2818 billion	-
2015	individual	4	298,000	74,625	721,000	10
	corporate	4	4,365,000	1,091,250	2.4445 billion	0.04
2016	individual	2	225,600	112,800	697,000	16
	corporate	2	6,300,000	3,150,000	2.6645 billion	0.12

THE
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5 July 2017

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Dear Noranne

RE: Independent Review of the Financial Reporting **Council's** Enforcement Procedures Sanctions – Call for Submissions.

The Investment Association represents the asset management industry in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of approximately £5.7 trillion of assets, which are invested in companies globally. In managing assets for both retail and institutional investors, the IA's members are major investors in companies whose securities are traded on regulated markets.

We welcome the FRC undertaking this independent review of its Enforcement Procedures Sanctions and the opportunity to respond to the Review Panel's call for submissions. In this submission, in view of the importance of accounting and audit to investors and the markets, we have focused on these aspects of the review. We also sought input from the members of the Company Reporting and Auditing Group (CRAG) in that it is the main UK grouping of buy side institutional investors that specifically focuses on accounting and auditing issues. (We did not, however, consult with CRAG's chair on the basis he is a member of the Review Panel.)

As users, investors have an interest in the requirements governing the preparation and audit of these companies' accounts. They consider it vital that appropriate sanctions are available to deter those responsible from breaching requirements and failing to uphold proper standards of conduct. This is important to ensure the markets trust and have confidence in the information reported.

We set out below our key observations on the matters raised in the Call for Submissions, and in the attached Annex our answers to the particular questions where we are able to comment.

- Since the implementation of the Audit Regulation and Directive, the threshold for disciplinary action in respect of audit has been revised to breach of a "relevant requirement". This is significantly lower than the previous test of "misconduct" and is welcome as is the enhancement of the FRC's powers.

- A number of audit enforcement cases, albeit these were under the Accountancy Scheme before the new Audit Enforcement Procedure was effective, have taken some years to conclude. To take three examples:

    - PwC's audit of Cattles plc – investigation announced in July 2009 and only settled in August 2016;
    - PwC's audit of Connaught plc - investigation announced in November 2009 and only settled in April 2017;and
    - Deloitte's audit of Aero Inventory plc - investigation announced in March 2011 and only settled in November 2016.

    In certain enforcement cases we are aware that the audit partner concerned may have retired by the time the sanctions are decided such that only a financial penalty has any impact.

    These long time frames do not help public confidence – one of the objectives of the Sanction's policy. Steps should be taken to ensure that cases are concluded in a much shorter time frame.

    In this context, whilst we appreciate discounts can be given for early settlement, they should also be available to reflect co-operation by the Respondent/Member/ Member Firm to help bring the case to a conclusion relatively quickly. This could deter those that we understand may seek obstruct proceedings by not responding to queries etc. on a timely basis and thus help to shorten the time it can take to conclude a case. The FRC would need to establish clear guidelines on what this involves in practice so that all parties are clear.

- The fines currently levied on the firms are not necessarily commensurate with the audit fee received for the audit in question or the revenue and profits for the firm as a whole. As such, they are unlikely to incentivise high quality audit work and/or compliance in the future. Taking two of the examples above:

    - In respect of the audit of Cattles, PwC was fined £2.3million or 0.067% of Group revenue and 0.26% of Group operating profit for the year to 30 June 2016; and
    - In respect of the audit of Aero Inventory, Deloitte was fined £4million or 0.13% of Group revenue and 0.66% of operating profit for year to 31 May 2016.

    This should be addressed and more consideration should be given to using non-financial sanctions such as barring: individual practitioners from providing accounting and auditing services; and firms from participating in tenders for a period.

- Audit firms are international as are many audits. Any proposals to increase sanctions need to be commensurate and comparable with those imposed by other regulators. We thus consider that this matter should be co-ordinated internationally.

I trust that the above and attached are self-explanatory but please do contact me if you require any clarification of the points raised or to discuss any issues further.

Yours sincerely

Liz Murrall

Director, Stewardship & Reporting

The Investment Association's answers to the detailed questions in the Call for Evidence.

Our answers to the detailed questions raised are set out below.

1. Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We support the objectives set out in paragraph 9 of the Sanctions Guidance in respect of the Accountancy Scheme and Accountancy Regulations, and in paragraphs 11 and 12 of the Sanctions Policy (Audit Enforcement Procedure (AEP)). It is vital that the sanctions available operate to maintain and promote market confidence in the accountancy and auditing professions, and the quality of corporate reporting.

2. Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

We consider that the Sanctions Guidance/Sanctions Policy are broadly satisfactory. Whilst we are not able to comment on the needs of Decision Makers, as defined, we believe it would provide clarity to the market if the FRC developed guidelines which divided offences into categories, and set a range of penalties for each category having regard to the aggravating and mitigating features of the offence. By comparing the penalties imposed within a category investors could assess the seriousness of a particular offence. We note that the ICAEW has a detailed and prescriptive tariff in its Guidance on Sanctions. This is helpful but we consider that the type and range of cases that the FRC has to deal with would make such a prescriptive list difficult to compile.

4. In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

We support the existing regime whereby both the firms and, to a lesser extent, the responsible individuals are sanctioned. Whilst an individual may have been responsible for the offence the fact that it occurred and was not addressed at the time is a failure of the firm's systems and controls. In general, we also consider that the smaller financial penalties imposed on individuals are largely of the right magnitude. Imposing excessive penalties on individuals could deter the more talented from undertaking audits. However, there are certain of our members that consider that sanctions should be imposed on individuals rather than the firms. It is usually individuals that are ultimately responsible for the enforcement case concerned and they consider focusing on the firms could result in those that are not responsible being adversely impacted.

6. To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

Since the implementation of the Audit Regulation and Directive, the threshold for disciplinary action in respect of audit has been revised to a breach of a "relevant requirement". This is significantly lower than the previous test of "misconduct" and is welcome as is the enhancement of the FRC's powers.

That said, we do not consider that the current sanctions necessarily meet the regulatory objectives. A number of audit enforcement cases, albeit these were under the Accountancy Scheme before the AEP was effective, have taken years to resolve. For example:

- PwC's audit of Cattles plc – investigation announced in July 2009 and only settled in August 2016;
- PwC's audit of Connaught plc - investigation announced in November 2009 and only settled in April 2017;and
- Deloitte's audit of Aero Inventory plc - investigation announced in March 2011 and only settled in November 2016.

In certain enforcement cases, we are aware that the audit partner concerned may have retired by the time the sanctions are decided such that only a financial penalty would have

any impact (we understand this was the case in respect of the audit engagement partner for Connaught plc).

This does not promote public confidence – one of the regulatory objectives. We consider it important that steps are taken to ensure that cases are concluded in a much shorter time frame.

7. In relation to financial penalties are they being set at the right level?

As regards the financial penalties, we note that for two of the cases cited above:

- In respect of the audit of Cattles, PwC was fined £2.3million or 0.067% of Group revenue and 0.26% of Group operating profit for the year to 30 June 2016 (albeit the original fine was £3,500,000 discounted for settlement) and the audit engagement partner was fined £75,600 (£150,000 discounted for settlement);
- In respect of the audit of Aero Inventory, Deloitte was fined £4million or 0.13% of Group revenue and 0.66% of operating profit for year to 31 May 2016 and the audit engagement partner was fined £150,000.

We do not consider that the fines imposed on the firms are necessarily commensurate with the audit fee received for the audit in question, or the revenue and profits for the firm as a whole. As such, they are unlikely to incentivise high quality audit work and/or compliance with rules, regulations and standards in the future. This should be addressed.

Understandably the fines for individuals are much smaller. Whilst we would not necessarily want the income of those individuals to be disclosed, it would seem sensible that the fines imposed should be based on their income from the firm. As noted under question 4, on the whole we would be concerned should excessive penalties be imposed on individuals as it could deter the more talented from undertaking audits. However, certain of our members consider that sanctions should be imposed on individuals rather than the firms in that imposing sanctions on the firms could result in those that are not responsible being impacted.

Lastly, audit firms are international as are many audits. Any proposals to increase sanctions need to be commensurate and comparable with those imposed by other regulators. We thus consider that this matter should be co-ordinated internationally.

10. Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

For the reasons stated elsewhere in this response, we do not consider that the current sanctions necessarily promote or incentivise good behaviour, or promote public confidence. First, cases can take too long to be decided and secondly, when they are decided the sanctions can be insufficient (see questions 6 and 7). Moreover, cases do not often receive much publicity. We believe that giving them a higher profile would help incentivise good behaviour.

11. Should there be greater use of non-financial sanctions?

We believe that, as well as fines, consideration should be given to using more non-financial sanctions such as: excluding the practitioner from providing accounting and auditing services; and barring the firm from participating in audit tenders for a period.

We do not consider that sufficient use is made of these sanctions at present. Moreover in extreme cases, where there has been loss, consideration should be given to awarding an order for some form of restitution.

The Investment Association's answers to the detailed questions in the Call for Evidence

12. Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

    (a) operating satisfactorily; or
    (b) inappropriate, and, if so, why?

We note that when:

- a Respondent accepts a Decision Notice under the AEP, any fines can be adjusted to reflect any disposal or early resolution; and
- a Member or Member Firm under the Accountancy Scheme admits the facts of the case then any of the sanctions can be reduced or if a settlement is agreed then the fine can be adjusted accordingly.

We support this as it is helps ensure that cases are settled earlier than may otherwise be the case. However, given the protracted nature of so many of the cases (see question 6), we consider that discounts should also be available to reflect co-operation by the Respondent/Member/ Member Firm such that the case is concluded relatively quickly. This could deter those that we understand may seek to obstruct proceedings by not responding to queries on a timely basis etc. and thus help to shorten the time it can take to conclude a case. The FRC would need to establish clear guidelines on what this involves in practice so that all parties are clear.

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Noranne Griffith,

Review Panel Secretary

c/o The Financial Reporting Council

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30th June 2017

Dear Ms Griffith,

Thank you for the opportunity to contribute to the review of sanctions imposed on auditors and actuaries under the FRC's current enforcement procedures. This covering letter and the response to the specific questions in attached consultation document have been developed jointly by The UK Shareholders' Association (UKSA) and The UK Individual Shareholders' Society (ShareSoc). Both organisations represent the interests of private shareholders who invest (directly or indirectly via nominee accounts) in public companies or in other forms of equity-based investment. Both are independently funded by concerned individuals who pay a membership fee.

In addition to our specific responses to questions in the consultation document, we have a number of general comments to make. These concern the need to ensure that the audit sanctions are perceived by investors and others to be fulfilling their purpose.

- **Definition of misconduct:** This is conspicuous by its absence in the consultation document. Those who search can find it in 'The Accountancy Scheme' document dated 1st July 2013 on the FRC's website. It defines misconduct as follows:

  "Misconduct means an act or omission or series of acts or omissions, by a Member or Member Firm in the course of his or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession."

  Although the words 'falls significantly short' are open to interpretation, this seems a generally appropriate definition which supports the key objective of the sanctions which is to 'protect the public and the wider public interest'. It would be helpful if it were clear that lack of detailed analysis and investigation, errors of judgement and a failure of curiosity by auditors (leading to a failure to ask the right questions) all fall within the above definition.

- **Accounting for culture:** We are not convinced that the objectives are being met as fully as we would wish. Ten years after the banking crash accounting scandals continue to emerge. There is now a widely held view that the banking crash was partly the result of a failure of corporate culture and, by implication, governance. The way in which supplier rebates were accounted for at Tesco and evidence of fraud at BT's Italian operations are two notable recent examples.

    - Terry Smith noted in September 2014, when Tesco issued two profits warnings within six weeks, that in fourteen of the previous eighteen years Tesco's free cash flow less its dividend was a negative number. In order to compensate for this and provide sufficient cash to pay the dividend the company borrowed. Debt rose from £894m in 1979 to £15.9bn in 2009. This is neither healthy nor sustainable. Those familiar with Tesco will also be aware that it was well-known for its famously aggressive stance with its suppliers on matters such as pricing and payment terms. Putting these two factors together one might have expected an enquiring and diligent audit team to look closely at issues such as the booking of supplier rebates.

    - Inappropriate behaviour at BT's Italian Division has resulted in an overstatement of earnings which has, apparently been taking place over a number of years. Write-downs are expected to exceed to exceed £530m. BT, a quasi-monopoly, is well-known for its cavalier attitude towards its customers and the way in which it has tested the patience even of Ofcom. It was also recently fined £42m for breaching contracts with telecoms providers.

    Both of these companies have consistently, over time, displayed culture and attitudes which might prompt auditors to take a closer look at accounting practices in these businesses. Accounting problems should not have come as a surprise. The public has been neither protected nor well served by the auditors in either case.

- **Penalties for failure:** We discuss the application of sanctions in our response to the consultation questions. However, in order to maintain public confidence in the system of sanctions, it is important that they are applied in a way that carries real force and meaning. Financial sanctions alone, particularly on the audit firm as opposed to individuals, have limited deterrent effect. The threat of suspension or disqualification for individuals is likely to carry much more weight. The same is true of a requirement on firms to state when bidding for work whether there have been any sanctions taken against the firm within, say, the last five years. If so they should be obliged to give details.

We do not believe that it is necessarily the role of auditors to report on corporate culture. However, we do believe that auditors should be mindful of the prevailing culture within a business when they take on and carry out the audit. Their assessment of the culture should help them to ensure that the audit is sufficiently rigorous to protect their ultimate clients, the investors.

Yours sincerely,

Peter Parry – Policy Director, UK Shareholders' Association

Cliff Weight – Policy Director, UK Individual Shareholders' Society

Independent review of the FRC's enforcement procedures sanctions.

Response from the UK Shareholders' Association and ShareSoc.

Question 1
Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

The objectives set out in paragraph 9 of the Sanctions Guidance for the Accountancy Scheme (which are the same in the Actuarial Scheme Sanctions Guidance) are set out in Appendix 2. The objectives of the Audit Enforcement Procedure specifically in relation to sanctions are encapsulated in paragraphs 11 and 12 of the Sanctions Policy (Audit Enforcement Procedure) which are, also, set out in Appendix 2.

Answer: The objectives as set out are satisfactory and we agree that:

'The primary purpose of imposing sanctions for acts of Misconduct is not to punish, but to protect the public and the wider public interest'

However, as discussed below, the threat of meaningful punishment for those who transgress is an important means of achieving this end.

Question 2
Is the Sanctions Guidance/Sanctions Policy (despite its different title, the Sanctions Policy does provide guidance to decision-makers.) satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:

(a) guidance, either of the current or some other type;

(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or

(c) some form of guideline which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.

Answer: The guidance given (a. above) appears to be satisfactory as far as it goes. It is difficult to assess this fully without having been directly involved in using the guidance and applying it. However it appears to strike a fair balance between being excessively prescriptive on the one hand and unhelpfully vague or superficial on the other.

It would be helpful to give decision makers some form of tariff guidance (b. above). This might take the form of a number of examples or case studies. Appendix 3 suggests that something along these lines is already in place. However, the cases need a commentary to say why a specific tariff was applied plus an indicative range of tariffs (upper and lower limits) that might

reasonably have been expected in each case. This should reflect the fact that setting tariffs is a matter of judgement and balance rather than a simple mechanistic process.

Proposal (c.) above looks as though it would be helpful, possibly combined with our suggestion above for proposal (b.).

Question 3
In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

Answer: See response to proposals 2 (b) and 2 (c) above. The guidance needs to be structured in such a way that users can quickly identify those cases that are relevant to / similar to the one under consideration before looking more closely at the detail of each one in order to assess how far they resemble or differ from the case in hand. Software systems are readily available to help with identifying and 'matching' similarities between cases so that quickly identify relevant previous cases for guidance. Any such system should not be treated as a mechanism which provides 'the answer'. The final decision should be the judgement of the tribunal taking into account all the facts at their disposal.

Question 4
In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

Answer: It is important that in any situation in which misconduct or negligence are proven to have taken place individuals are held to account. This means those who:

- were knowingly guilty of misconduct or negligence, and those who
- were responsible for the people whose conduct and competence fell short of expectations.

should have appropriate sanctions taken against them. If sanctions are designed primarily to protect the public and public interests (as suggested by the Objectives) then 'sanctions' here are likely to mean some form of temporary or permanent disqualification / suspension for these people.

It is important in this context that 'responsible individuals' includes those in senior positions who were responsible for defining the culture of the organisations and who, in their determination to, say, drive fee income growth and profitability, may have encouraged more junior staff to cut corners, turn a blind eye or go along with things that they knew to be wrong or inappropriate.

Firms should also be exposed to sanctions. Fines are almost certainly not the answer by themselves. A better approach would be to have a public register of firms (and individuals) that have had sanctions taken against them (e.g. reprimand or severe reprimand). It should also be obligatory for any firm bidding for work to have to state whether it has ever had any sanction

taken against it (regardless of whether the client ITT itself asks for this). In the most serious cases we would like to see more instances in which audit firms are prohibited from taking on new listed company audit clients for a specified period of time. Even if that period of time is relatively small, such as one month or three months, as a sanction we believe that it will be taken much more seriously by audit firms and the listed companies which engage them than a sanction such as a "severe reprimand".

Firms should also have to make good client losses resulting from negligence or misconduct. The extend of any 'making good' would need to vary depending on the extent of any contributory negligence or complicity on the part of the client.

Question 5
In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

If respondents think that the FRC should establish some starting point, they are invited to articulate;

(a) how they consider that starting point should be measured for entities or individuals (e.g. by reference to specified monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);

(b) how the starting point should be determined; and

(c) what criterion/a should produce what starting point(s).

Answer: Fining of individuals are an acceptable form of sanction in that they are likely to likely to give pause for thought on the part of all individuals who may be tempted to misbehave or cut corners. However, the fines should be:

- paid by the individuals (not by their employer)
- set at a fairly low level but should vary depending on the severity of the misconduct.

Sanctions should operate rather like those for driving offences. More minor offences result in a fine and some form of 'black mark' (license endorsements). More serious offences result in a driving ban with all that this implies in terms of ability to work and to obtain insurance in future.

Fining of firms has limited impact. There are more effective sanctions that can be taken as outlined in the response to Q4 above.

Question 6
To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

Answer: They fall short of meeting regulatory objectives – often by a large margin. The monetary penalties imposed so far on audit firms have been relatively minor compared with the revenues of such firms, and the non-monetary sanctions appear to have little impact on their reputations in the audit marketplace."

Question 7
In relation to financial penalties are they being set at the right level?

In answer to this question, respondents are invited to state;

(a) whether they think they are too low or too high, and

(b) by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.

Answer: See answer to Q 6 above. However, bear in mind that we are not great supporters of financial penalties. We believe that there are more effective sanctions that can be applied as outlined in the response to Q4 above.

Imposing fines on businesses in the financial service sector when they misbehave has become an almost automatic reaction from regulators. These may benefit the recipients of the money raised though fines (governments and regulators themselves) but, from an investor point of view) they have little impact on the offending firm and even less on the individuals who are responsible for the failings. Invariably it is the shareholders or owners of the business who end up paying the fine. This may be less true in the case of auditors as they are structured as LLPs and tend not to have external shareholders. However, the fact remains that most of the evidence points to the fact that sanctions against the corporate body have little impact in changing corporate culture and behaviour.

Question 8
If respondents think that financial penalties are too low is this because:

(a) failures of the type covered by the procedures require greater censure than is currently given;

(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;

(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;

(d) they do not promote public confidence; or

(e) some other reason?

Answer: We do not believe that the issue is one of whether financial penalties are too low. As indicated in the responses above, financial penalties are simply not the answer to the problem.

Question 9
What are the key elements in achieving effective deterrence?

Answer: There needs to be confidence in the public mind that all cases of audit failures which the FRC becomes aware of will be rigorously pursued.

Potential sanctions must be such that they will focus the minds of all concerned. Potential loss of employment and reputational damage are much more immediate and understandable to most people than the vague threat of a fine which will be paid by the company. The recent decision by the SFO to prosecute John Varley and three other former Barclays directors over the 2008 fundraising is already sending shock-waves through the City in a way that multi-billion pound fines at Lloyds and other banks for PPI miss-selling have never come close to doing.

Question 10
Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

Answer: It would appear not – on both counts.

Question 11
Should there be greater use of non-financial sanctions such as:

(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or

(b) an order for some form of restitution?

Answer: We favour greater use of non-financial sanctions. Options such as further training or restitution should always be considered. However, there is a need for subsequent third-party follow-up to check how effective such action has been in changing behaviour. It is not clear what attempts if any are made currently where such non-financial sanctions are used to see if behaviour has in fact changed.

Question 12
The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance[2], as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

(a) operating satisfactorily; or

(b) inappropriate, and, if so, why?

Answer: We have no particular view on this.

Question 13
Are there some sanctions which could usefully be imposed which are not currently available?

Answer: See suggestions in response to Q4 above – in particular, the suggestion that firms which have had sanctions applied against them should have to declare this and give details when bidding for any new work. Such a requirement might apply to any sanction applied in the last ten years as this is the timeframe within which the audit contract must be retendered under recent EU-based legislation.

Independent review of the Financial Reporting Council's enforcement procedures sanctions

Review Panel's call for submissions

Comments from ACCA
June 2017

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 188,000 members and 480,000 students in 178 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 100 offices and centres and more than 7,400 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting, and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

Further information about ACCA's comments on the matters discussed here may be requested from:

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GENERAL COMMENTS

ACCA welcomes the opportunity to make submissions to the Review Panel as part of its independent review of the FRC's enforcement procedures sanctions. The key principles that we set out in this submission, and which guide our responses to specific questions, are underpinned by case law as follows:

- It is settled law that the purpose of sanctions issued by a regulatory body is not to be punitive but to protect the public interest - *R (on the application of Abrahaem) v General Medical Council* [2004] EWCH 279 (Admin).

- The Court of Appeal in *Raschid and Fatnani v The General Medical Council* [2007] EWCA Civ 46 made it clear that the functions of a disciplinary tribunal are quite different from those of 'a court imposing retributive punishment'. The Court of Appeal went on to confirm, 'the panel is then concerned with the reputation and standing of a profession rather than the punishment of a doctor'. The public interest must be at the forefront of any decision on sanction, and this includes the collective need to maintain confidence in the accountancy profession and the particular need to declare and uphold proper standards of conduct and performance.

- In *Bolton v the Law Society* [1994] EWCA Civ 32, the Court said 'the reputation of a profession as a whole is more important than the fortunes of an individual member of that profession'.

  As the principal function of sanctions is not punitive but to protect the public interest, it follows that 'considerations which would ordinarily weigh in mitigation of punishment have less effect on the exercise of this jurisdiction.'

Therefore, the key principles upon which an effective sanctions policy should be based are as follows:

- As stated clearly in the Sanctions Guidance and Sanctions Policy, 'the primary purpose of imposing sanctions … is not to punish, but to protect the public and the wider public interest'.

- The imposition of a financial penalty is, in itself, inadequate, and should always be accompanied by a sanction such as a reprimand or conditions. In this way, the combination of sanctions makes clear the gravity of the breach, and the response considered appropriate to protect the public.

- As stated last year, in our comments concerning the FRC's proposed audit

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enforcement procedures, the Sanctions Policy should adopt a 'bottom up' approach which, in our view, is best practice in relation to disciplinary matters. A 'bottom up' approach to sanctioning assists in determining a proportionate sanction (or combination of sanctions), and helps to ensure that both proportionality and fairness are apparent. This approach also provides a means of identifying the appropriate sanction (or sanctions) to afford protection to the public, which might include a deterrent (to the party who committed the breach and to other parties).

- In order for a deterrent to be effective, and for the public to be adequately protected, publicity of the enforcement process and any sanctions imposed must be sufficiently clear and timely. Publicity should only be withheld in exceptional circumstances, and only to the extent required by the Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR), ie limited to the identity of the person sanctioned.

With these principles in mind, it becomes apparent that the use of tariffs is inappropriate, as assigning a particular sanction to a particular breach as a starting point ignores the surrounding facts and circumstances, and undermines the need for proportionality and a 'bottom up' approach. A tariff-based approach would be too restrictive, as the independent decision-makers must be seen to have flexibility, and the ability to exercise appropriate judgment. A tariff approach also does not align comfortably with the statement that punishment is not an objective of the Sanctions Policy.

AREAS FOR SPECIFIC COMMENT:

In this section, we set out our response to the specific questions set out in section 5 of the call for submissions.

Question 1: Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We believe that the stated objectives are correct. We particularly support the statement, in both the Sanctions Guidance and the Sanctions Policy (Audit Enforcement Procedure), that '[t]he primary purpose of imposing sanctions … is not to punish', as punishment is a matter for the courts.

Each document sets out the same four sanctions-related objectives. It is worthy of note that the first two objectives – deterrence and protection of the public - are of a different

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nature to the other two. The first implies that a sanction must be significant enough to have a deterrent effect. Therefore, like the second objective, it protects the public. The second objective adds the possibility that a sanction may serve to prevent an individual or firm from providing a certain service (or services) to the public.

The fourth objective – to uphold proper standards of conduct – is largely a product of the first two. This objective (as with the third) is only met if there is appropriate transparency, and the sanctions meet the other better regulation principles – particularly that they are targeted, proportionate and consistent.

Question 2: Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Broadly, we agree that the Sanctions Guidance and the Sanctions Policy (Audit Enforcement Procedure) are fit for purpose. However the approach to determining sanction makes no reference to a 'bottom up' approach to determining the sanction (or combination of sanctions) that is proportionate and achieves the stated objectives.

Panels imposing sanctions are under a duty to act proportionately. Any interference with a member's right to practise in their chosen profession will engage the right to respect for private and family life, which is protected by Article 8 of the European Convention on Human Rights. It was established in the case of *Huang v Secretary of State for the Home Department* [2007] UKHL 11 that any interference in a member's professional standing and ability to practise must be no more than the minimum necessary to uphold the public interest. The Committee must strike a balance between the rights of the relevant person and the public interest.

Acting proportionately requires panels to consider all the sanctions available to them in ascending order of severity. Panels should start with the least restrictive sanction, and proceed until finding the order that is sufficient to address the member's conduct or misconduct. This is the case whether the finding was made because of a need to protect the public, the maintenance of public confidence, or the need to declare and uphold proper standards.

Therefore, we believe improvements to the guidance are required and, once completed, decision-makers should always be provided with that guidance. The improved guidance should not include any form of tariff or prescribed range of penalties. Assigning a particular sanction (or range of sanctions) to a particular type of breach undermines the need for proportionality and a 'bottom up' approach. A tariff-based approach would impede independent decision-making, and the exercise of appropriate judgment. It may also obscure, to some extent, the fact that punishment is not an objective of the Sanctions Policy, and that the protection of the public is paramount.

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With regard to the sanctions themselves, we believe that a declaration that the statutory audit report does not satisfy the relevant requirements (paragraph 16(f) of the Sanctions Policy (Audit Enforcement Procedure)) is not a sanction. This is an administrative measure, which may be necessary to provide appropriate transparency and to protect the public; but it is a measure that is not dependent upon the outcome of an investigation or the decision-making process. We acknowledge that this measure is included along with sanctions under article 30a of Directive 2014/56/EU of the European Parliament and of the Council ('the EU Audit Directive'); but in the SATCAR (regulation 5(d)) it is combined with an order to forego or repay fees payable. Therefore, the Sanctions Policy would be clearer if the provision for such a declaration was removed from the list of sanctions, and explained elsewhere.

Question 3: In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

As we have already expressed our objections to any form of tariff system, we have declined to answer this question 3.

Question 4: In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

ACCA has consistently held core values of integrity and accountability. Therefore, we believe that the focus of an investigation and enforcement process should be on those seen as responsible – the entity, an individual (or individuals) or both.

There will be occasions on which a firm's systems or structures encourage, require or allow a breach, and the investigation and enforcement process must distinguish between such a systematic failure and the actions of a rogue individual. Nevertheless, where the focus is rightly on the firm the responsibility of the individual must also be considered, and vice versa. The FRC must stand willing to challenge a firm where the firm's systems have allowed a rogue individual to commit a breach, and also to challenge individuals who control or exercise significant influence within firms.

Of course, the FRC cannot investigate and sanction a client company under its enforcement procedures. Its remit extends only as far as those involved in the finance function of companies. But where an audit firm (or individuals within it) are subject to

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investigation, the responsibility of the finance director in the client company should not be overlooked.

Question 5: In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

The starting point for a financial penalty must be zero. A 'bottom up' approach to sanctioning allows a combination of sanctions, and it must be acknowledged that a public reprimand (or severe reprimand), for example, will probably have a greater deterrent effect than a financial penalty (which should not be set with the objective of punishing the entity or individual). Nevertheless, the level of any fine should be meaningful but proportionate. The appropriateness of the fine must be considered from the perspective of the accountancy profession, and also of the general public.

Question 6: To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

For a regulator focused on improving standards and protecting the public, the range of sanctions available to decision-makers is satisfactory. However, Appendix 3 to the call for submissions illustrates that there has been a steady flow of breaches in recent years. This might suggest that the sanctions being imposed have been less effective in meeting the regulatory objectives than intended.

We suggest that the Sanctions Guidance and Sanctions Policy could provide sharper alignment between the regulatory objectives and the sanctions available. The quality of decision-making will then be apparent through transparent publicity around sanctions, and a clear understanding of the need for publicity will also focus the minds of decision-makers on being seen to meet the regulatory objectives. We believe that the importance of such publicity is illustrated in paragraph 19(vii) of the Sanctions Policy (Audit Enforcement procedures), which states that the sanctions approach should include: '[giving] an explanation at each of the six stages above, sufficient to enable the parties and the public to understand the Decision Maker's conclusions'.

Question 7: In relation to financial penalties are they being set at the right level?

It is not for ACCA to answer this question in such a way as to undermine the judgment of decision-makers. However, we have responded to other questions (and in our general comments) above with regard to key principles upon which an effective sanctions policy should be based. We should also reiterate here the importance of sanctions guidance and transparency throughout the enforcement process.

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There is a risk that a more robust sanctions procedure may simply be translated into higher financial penalties. However, the satisfaction of public demand in this way (if any) would be short-term. It is for the Sanctions Policy, and transparency of the enforcement process, to demonstrate that regulatory action taken is proportionate, well-reasoned and in the public interest, rather than simply satisfying the perceived demands of the public.

Question 8: If respondents think that financial penalties are too low is this because:

a) **failures of the type covered by the procedures require greater censure than is currently given;**

b) **they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;**

c) **they are insufficient to incentivise either high quality audit work / compliance with rules, regulations and standards;**

d) **they do not promote public confidence; or**

e) **some other reason?**

It is not appropriate for us to respond to this question, given our response to question 7 above. We have focused our earlier responses on being clear about the principles for an effective sanctions policy, and the need for clear and effective guidance for decision-makers, and effective publicity of any sanctions imposed.

Question 9: What are the key elements in achieving effective deterrence?

Within the structure of an effective sanctions policy, it is for the decision-makers to determine the level of sanction that is sufficient to provide an effective deterrent. However, transparency (including clear publicity of findings and sanctions), while not in fact a sanction, has a significant deterrent effect (through its inevitable impact on reputation), as well as demonstrating fairness. Therefore, appropriate transparency promotes respect for the regulatory process. The withholding of publicity should only be in exceptional circumstances.

Within the range of sanctions available, the removal of the right to practise in certain areas and the imposition of conditions are primarily for the protection of the public. But

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these measures also act as deterrents, and they are perceived as such by accountants and auditors. Within a 'bottom up' approach to sanctioning, these protection measures might be seen as a minimum level of sanction. However, their deterrent effect should also be assessed, especially when combined with a public reprimand, for example.

In respect of financial penalties, the deterrent effect of financial loss alone is difficult to predict, but is unlikely to be significant unless the level of financial penalty is punitive. Apart from this being perceived as contrary to the sanctions objectives, such an approach could be seen as unfair, as any fines on corporations are ultimately borne by the shareholders.

Question 10: Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

We suggest that this is, in fact, an inappropriately worded question. It may be argued that no auditor intends to perform a bad audit, and so it is not the purpose of sanctions to 'promote or incentivise good behaviour'. However, with regard to promoting public confidence, the Review Panel should try to establish whether robust and well-publicised sanctions are being imposed, and whether those who impose the sanctions are seen to be independent decision-makers. These elements combine to promote respect for the regulatory framework, which will serve to incentivise the regulated community to act diligently and appropriately.

Question 11: Should there be greater use of non-financial sanctions such as:

a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or

b) an order for some form of restitution?

The non-financial sanctions suggested are already available under the Sanctions Policy and the SATCAR, although they have not been used recently. In employing a 'bottom up' approach to sanctioning, non-financial sanctions could be used (perhaps in combination with financial sanctions) to provide more proportionality and better protection of the public. Guidance provided to decision-makers should encourage them to explore the options available to them.

Under the Sanctions Policy and the SATCAR, a decision-maker may order a respondent to take action to mitigate the effect of a breach of relevant requirements. The other form of restitution available is the waiving or repayment of fees that would

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otherwise be payable. While the return of fees would usually be seen as fair and reasonable, care should be taken to ensure that such sanctions do not send the wrong message, as it is difficult to argue that mere restitution either acts as a deterrent or provides a measure of protection to the public. In addition, seeking restitution would usually be considered to be a civil matter, to be dealt with through the courts.

Question 12: The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

a) operating satisfactorily; or

b) inappropriate, and, if so, why?

We feel that we are not close enough to the sanctioning process to be able to assert that the provisions for discounting a sanction are operating satisfactorily. In future, we should like to see detailed published reasons for the level of sanction, using a 'bottom up' approach, which would then make the impact and reasonableness of any discount clearer to the public.

However, in principle, some provision to be able to discount a sanction is appropriate, as it allows the process of determining sanction to demonstrate proportionality – weighing the sanction against the potential costs of protracted investigations and hearings. However, care should be taken to ensure that the public interest of such discounting is evident, and that the deterrent effect (and the protection of the public) is retained (and seen to be so). Therefore, a discounted sanction should only be determined where appropriate insight has been demonstrated, and there should never be any suggestion that the discount came about simply as the result of a 'deal' between the parties.

Following the decision in *Bolton v the Law Society* (quoted above), any discount to a sanction should not be related to remorse or the personal circumstances of the individual (eg paragraphs 64 (j) to (l) of the Sanctions Policy (Audit Enforcement Procedure)[1]) in such a way as to suggest that the discount is in respect of a mitigation of the *punishment*.

[1] These paragraphs state that matters that should be taken into account when deciding the sanction or combination of sanctions to be imposed include:

- that a Statutory Auditor held a junior position;
- a Statutory Auditor's personal mitigating circumstances;
- that a Statutory Auditor or Statutory Audit Firm has demonstrated contrition and/or apologised for the breach of the Relevant Requirements.

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Question 13: Are there some sanctions which could usefully be imposed which are not currently available?

We are not aware of any useful sanctions that are currently unavailable. However, it would appear that only a limited range of available sanctions has been used in recent years. This suggests that improvements could be made to the sanctions guidance. But we also believe that the sanctions-related objectives would be better met if the Sanctions Policy was to require a 'bottom up' approach.

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Dear Noranne

We are grateful to the Review Panel for the opportunity to comment on the review of sanctions imposed under the FRC's enforcement procedures; our response to the questions posed are as follows:

Question 1:
Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?
In relation to the Accountancy Scheme, yes, but suggest consideration be given as to whether some modifications along the following lines (in italics) would improve:

"To maintain and promote public and market confidence in the accountancy profession and the quality *and integrity* of corporate reporting; and"

"The primary purpose of imposing sanctions for acts of Misconduct is not to punish, but to protect the public and the wider public interest. Therefore a Tribunal's objective should be to impose the *fair and proportionate* sanction or combination of sanctions necessary to achieve the objectives of the Scheme"

Question 2:
Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?
We would support the provision to decision makers of the guidance suggested at example (c), which would divide regulatory offences into categories and prescribe a range of penalties having regard to aggravating and mitigating features of the offence within the category. It is acknowledged that such factors are already taken into account when considering the imposition of sanctions though this is currently not in relation to prescribed categories.

Question 3:
In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or detailed guidelines would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance should take.
We would suggest that the public perception of sanctions is both relevant and important in this regard as well as the financial impact on the public of the given circumstances of the misconduct. For firms with substantial turnover or highly paid executives found culpable of misconduct - often with insurance provision for legal fees and costs – even fines of significant sums may not be perceived as providing the appropriate redress nor as a longer term deterrent.

Question 4:
In imposing sanctions, should decision- makers seek to place any particular focus on entities rather than individuals or vice versa?

We would suggest that a large fine attributed to an entity, would not have the same impact on subsequent corporate behaviour as attributing personal liability to individuals responsible for creating the management problem.

Question 5:
In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?
No

Question 6:
To what extent do current sanctions meet regulatory objectives? If they do not, why is that?
We would suggest the measure would be the extent to which overall regulatory compliance and market confidence can be demonstrated to have improved over the duration of the Scheme(s).

Question 7:
In relation to financial penalties, are they being set at the right level?
Not if they do not act as a deterrent to future offending.

Question 8:
If respondents think that financial penalties are too low is this because ….
In some cases, possibly too low as there is evidence of repeat offending; public confidence in business also remains low.

Question 9:
What are the key elements in achieving effective deterrence?
Such elements might include heightened publicity; requirement to notify to shareholders; potential negative and long term impact on reputation and income; potential restrictions on employability.

Question 10:
Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?
Not always and not consistently; for example in respect of complex cases running over a significant period of time, some of the individuals under investgation may have retired from employment by the time determinations are reached, and therefore the impact of any sanctions imposed is diminished.

Question 11:
Should there be greater use of non-financial sanctions?
Yes, we would consider that an order for some form of restitution as set out at option (b) to be a good idea warranting further consideration; some form of public acknowledgement of wrong doing would help rebuild confidence. The current provision to impose a direction could be developed further.

Question 12:

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement…Are these provision operating satisfactorily, or inappropriate, and if so, why?

It is appropriate that the current provisions apply to fines rather than to the period during which a firm or individual is precluded from practising, and that the protection of the public remains paramount.

Question 13:

Are there some sanctions which could usefully be imposed which are not currently available?

Possibly some form of corporate integrity points system or record.

We hope that this feedback will assist.

Best wishes.

Gail Stirling
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Independent review of the Financial Reporting Council's enforcement procedures sanctions

ICAEW Professional Standards welcomes the opportunity to comment on the document *Independent review of the Financial Reporting Council's enforcement procedures sanctions* published by the Financial Reporting Council (FRC) in May 2017, a copy of which is available from this link. This response is dated 30 June 2017.

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ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

ICAEW as a regulatory body is;

(a) the largest recognised supervisory body (RSB) and recognised qualifying body (RQB) for statutory audit in the UK, registering approximately 3,000 firms and 7,500 responsible individuals under the Companies Act 1989 and 2006.
(b) the largest prescribed accountancy body (PAB) and recognised accountancy body (RAB) for statutory audit in Ireland, registering approximately 3,000 firms and 7,500 responsible individuals under the Companies Act 2014
(c) the largest recognised supervisory body (RSB) for local audit in the UK, registering approximately 10 firms and 100 responsible individuals under the Local Audit and Accountability Act 2014
(d) the largest single insolvency regulator licensing some 750 insolvency practitioners as a recognised professional body (RPB) under the Insolvency Act 1986 out of a total UK population of 1,700.
(e) a designated professional body (DPB) under the Financial Services and Markets Act 2000 currently licensing approximately 2,300 firms to undertake exempt regulated activities under that Act.
(f) An approved regulator (AR) and licensing authority (LA) for the reserved legal service of probate licensed them as Alternative Business Structures (ABSs) for probate services
(g) a supervisory body recognised by HM Treasury for the purposes of the Money Laundering Regulations 2007 dealing with approximately 13,000 member firms.

In discharging these duties ICAEW are subject to oversight by the FRC's Conduct Committee, the Irish Auditing and Accounting Supervisory Authority (IAASA), the Insolvency Service, the FCA and the Legal Services Board.

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Executive summary

1. The FRC have invited comments from a number of stakeholders to a consultation on the sanctions arrangements of the FRC Conduct Committee in the light of the recent new Enforcement Procedure implemented following the implementation of EU audit reforms under the Statutory Auditors and Third Country Auditors Regulations 2016 (SI649, SATCAR).

2. ICAEW welcome the timing of this review and the opportunity to be able to input to the considerations by the Review Panel that has been set up to consider the evidence and submissions.

3. Enforcement and sanctions are an essential part of the audit oversight process. They are set out as requirements in the EU Audit legislation and Companies Act requirements, but have also been applied in the UK by the accountancy profession for many years preceding statutory requirement.

4. We continue to be broadly comfortable with the general positioning of the Sanctions Guidance and Policy of the FRC as they stand, but are concerned about certain directions that the consultation is exploring and are anxious that adherence to the Nolan principles particularly around proportionality are borne in mind in any major changes being applied to the policies and approaches.

5. Regulation is applied through the firm and the individual, and shortcomings when they occur may be down to either or both in varying degrees. It is important that any enforcement measures recognise that balance and are not unnecessarily weighted toward one rather than the other.

6. Our principal concern is that some of the proposed changes in policy are focused on exacting a punishment commensurate with the power of other regulators, and give little regard to the impact on the economic functioning of the market place as it applies to both audit and professional services as a whole. Fines that are too demanding and thoughts of restitution change the risk profile of an accounting firm considerably and affect the insurability of its trading. In such circumstances market exit from what is already a narrow market would become a real possibility for one or more firms including the big 4. This would affect the competition and run contrary to the competition objective expected of the FRC by the Competition and Markets Authority. The setting of fines in our view should be linked solely to the audit operation of a firm and be a discomfort but not terminal to its trading position.

7. We also believe that public confidence in a regulated environment is as much bound up in the mere presence of an oversight structure rather than its enforcement. Proportionate individual sanctioning illustrates the robustness of that regime, but large fines and big headlines actually serve to undermine rather than strengthen public confidence not only in the quality of audit but in the calibre of those overseeing it – such as the FRC itself. Care is therefore required to ensure balance is properly observed in setting any sanctions guidelines.

8. We also find expulsion of firms or individuals as a means of penalty disproportionate save where integrity or dishonest are involved. No other professional oversight area to our knowledge applies such a penalty for inadvertence and as this approach affects the ability of the individual to find work and rehabilitate, it could be considered open to challenge under Human Rights legislation. We therefore expect this approach to be used sparingly for only the greatest of misdemeanours.

9. We have limited our comments in relation to sanctions for the Accountancy Scheme to sanctions for complaints against members of the Participants working in business given the current discussions ongoing regarding the reduction in scope of the Scheme.

Detailed responses

Q1 Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory?

10. The objectives set out in these two documents have been used by the FRC for many years. We are broadly in agreement that these objectives are right ones. However, it is neither in the public interest, nor in the interests of proper functioning capital markets, for the size of sanctions to rise to a level which might reduce the number of major firms being prepared to offer audit services.

Q2 Is the Sanctions Guidance/Policy satisfactory and fit for purpose in current circumstances?

11. We consider that the Guidance and Policy are broadly satisfactory subject to the specific comments made below.

Q3 In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

12. We disagree with the conclusion regarding the lack of suitability of a tariff or detailed guidelines. Detailed guidelines have been used by ICAEW Investigation Committee and the Disciplinary Tribunal for a long time where the Committee / the Tribunal deals with a far broader range of matters than are considered by the FRC Tribunal.

13. There are two clear advantages to the use of a detailed guidance. Firstly, there is certainty for the firm or individual as to the potential size of the penalty which might be incurred which might act as a more effective deterrent rather than guidance which gives no real indication of likely outcome. Secondly, detailed guidance helps to provide greater consistency between sanctions handed down by tribunals with changing members who, otherwise, have to spend time learning about the fact pattern behind other Tribunal cases in order to compare and contrast. Indeed it is been clear from comments made by FRC Tribunals in recent judgements, or by those approving settlement agreements, that those determining sanctions have really struggled with the lack of starting point tariffs in the current Guidance and Policy

Q4 In imposing sanctions should decision makers seek to place any particular focus on entities rather than individuals or vice versa?

14. In respect of audit matters, the appropriate allocation of sanctions between firms and engagement partners should follow from the findings made by the Tribunal as to the reason for the failure. If the failure has resulted from a team failure or as a result of process failures, the firm should be the focus of all or the main part of any sanction. In contrast, if the partner has deviated from the firm's processes or has been personally culpable in respect of some of the key issues then this would indicate some sanction being attributed to the partner.

15. In respect of members in business found to be culpable under the Scheme, sanctions should match their individual culpability bearing in mind the position they held at their company.

Q5 In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

16. The FRC should consider establishing starting points for sanctions but that these should not be minimum "starting points" but would be subject to adjustment downwards and upwards for mitigating and aggravating factors. ICAEW operates this system which helps provides consistency.

Q6 To what extent do current sanctions meet regulatory objectives? If they do not why is that?

17. ICAEW's main criticism of sanctions imposed in recent cases has been the use of the sanction to expel members for a minimum recommended period of time where there has been no finding of dishonest conduct or lack of integrity on the part of the auditor or member in business.

18. If a Tribunal makes a finding that there has been poor audit work by the engagement partner, then the most directly relevant penalty would be to prevent that partner from signing audits for a period of time until that partner had received appropriate training to bring him / her to the standard to be expected. This would fall in line with the primary objective of protecting the public interest. Any decision to expel that individual from membership of his / her professional body would appear to serve no purpose other than to punish that individual. Indeed, it would seem to be a regressive step as, once expelled, that individual would not have access to the material and help which could be given by his / her professional body to gain further education and training to improve their performance.

19. The decision to expel partners also runs contrary to the approach adopted by ICAEW disciplinary tribunals and tribunals of other professional bodies which would only seek to impose expulsion on a member if that member has been found guilty of dishonesty or a lack of integrity. In those circumstances, the professional bodies would consider that the individual was no longer fit to be a member of that body. However absence dishonesty or lack of integrity, and where the failing relates to a lack of competence, this would not be seen as something to merit expulsion.

20. Likewise, absent dishonest or lack of integrity, it is difficult to understand how the expulsion of an individual working in business from membership of a professional body responds to the primary regulatory objective or helps with the educational and learning needs of that individual. The member's professional body is the vital support line for the member in such circumstances. Expulsion does not prevent that individual from continuing to work in business or as a director and the individual will do so outside of the disciplinary processes operated by professional bodies and the deterrent this provides against poor conduct.

Q7 In relation to financial penalties are these being set at the right level?

Q8 If respondents think that financial penalties are too low is this because;

(a) Failure of the type covered by the procedures require greater censure than is currently given;

(b) They are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned

(c) They are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards

(d) They do not promote public confidence

(e) Some other reason?

21. It is arguable that the financial sanctions are already too high in relation to audit with an increasing diversity between the amount of the fees earned by the audit firm for the relevant audit engagement and the financial sanction. The sanctions in ICAEW's disciplinary system

for audit failure revolve around the fees earned by the firm from the engagement and a multiple is applied depending on the seriousness of the failure. This seems a far appropriate and proportionate anchor for the setting of a sanction.

22. Instead, the current FRC guidance creates sanctions which appear to be a disproportionate and wholly unrelated measure of the total revenues of the firm for that year. With audit revenues being a decreasing percentage of turnover of major UK firms, the audit fines are now in reality being linked to more and more revenue generated by many parts of the business which have nothing to do with audit. If a financial measure is to be used beyond the fees for the engagement, serious consideration should be given to changing this to the revenues from audit.

23. The FRC should consider the long term consequences of any move to increase financial sanctions to match those imposed by other regulatory and criminal prosecution authorities such as the FCA and the SFO. The FRC should take into account how limited the supply is at certain points in the market and what might happen if, as a result of increased sanctions and risk of reputational damage, one or more of the major accountancy firms were to cease offering audit services.

24. Such a development would be significantly adverse to the public interest, the interest of business and the efficient and effective operation of the capital markets as there are only a limited number of firms who have international networks with sufficient expertise and depth to carry out audit work for the largest international companies. The FRC needs to consider carefully the decreasing attraction of audit services because of the lower profitability of this work and the decreasing revenues earned through audit work as a percentage of a firm's total turnover. While the FCA imposes far larger financial sanctions than the FRC, the financial services market is not as consolidated or vulnerable.

25. ICAEW, like other Recognised Supervisory Bodies, would also be seriously concerned at any increase in the current level of sanctions which would also serve to increase the current disparity between the financial penalties which are imposed by professional body tribunals (which, for audit, are more geared around the fees earned for the engagement) and the fines imposed by the FRC. While ICAEW's Regulatory Board is currently undertaking a review of ICAEW's more prescriptive Sanctions Guidance, this is unlikely to move from a methodology which is based around the fees for the audit work.

26. ICAEW is also a Recognised Professional Body for insolvency work and has recently worked with another of its oversight bodies, the Insolvency Service, and the other RPBs on changes to the Common Sanctions which will be imposed by all of the RPBs in the future. With the Insolvency Service's support, the relevant part of ICAEW's (and other bodies') Sanctions Guidance has now been re-worked to focus on the fees earned from the insolvency work which is the subject of the complaint and, in particular, on the likely profit which might have been made by the insolvency practitioner from that piece of work.

27. Given that audit sanctions imposed by the FRC, taking into account the total revenues of the accountancy firm and being far greater than the fees earned for the engagement, are already significantly different to the insolvency sanction regime, any move to increase financial sanctions would just increase the disparity between the financial sanctions imposed for different work carried out by accountants. There would be little justification for this, with there being just as much public interest in ensuring an effective sanctioning regime where insolvency practitioners act as officers of the court and assume positions of trust running companies in financial difficulty.

Q9 What are the key elements in achieving effective deterrence?

28. The key element in achieving effective deterrence is viewing the whole audit approach as an obligation through professionalism, ethics and high quality standards. That is achieved through qualification and training. Regulation and enforcement should be seen as a didactic led process and not one that simply penalises individuals and firms for shortfalls in performance.

Q10 Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

29. We believe that current sanctions do assist with greater degree of care being taken in carrying out audit work for the fear of the career, financial and reputational consequences of getting it wrong. However, while the imposition of sanctions in a blaze of publicity may promote public confidence in the effectiveness of the audit regulator, it is likely to have an adverse effect on public confidence in the audit profession.

30. This is something which the FRC needs to take account of when considering whether to move from its current position. Bigger financial sanctions, with larger headlines, are only likely to drive public confidence in the value and integrity of audit work lower and this is regretful given that, for every piece of audit work being sanctioned, there is a lot of great work being carried out – completely unheralded – by auditors querying and challenging management and obtaining significant changes to companies' financial statements so that the investing community and the public are not being misled.

31. We would also point out that the incentivisation or promotion of good behaviour must rest primarily with the audit firms to ensure that there will be repercussions in terms of career-progression for individuals who fall short of the standards reasonably to be expected.

Q11 Should there be greater use of non-financial sanctions such as;

(a) The imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirements for further training; and/or

(b) an order for some form of restitution?

32. We agree that there should be a greater use of non-financial sanctions so that the cost is borne by the individual or on a firm's audit practice and that the rest of a firm with many non-auditors is not being punished. Placing conditions on the ability of an auditor to practise together with requirements for the auditor to undertake particular training would be the most effective way of sanctioning a poorly performing order always with the view to that auditor being sufficiently rehabilitated as a result of the training to re-start audit work again.

33. We do not believe that it would be appropriate, necessary or practical to impose conditions preventing a firm from practising in a particular area (it's not clear what areas the FRC has in mind) unless there was some form of catastrophic failure. It would seem incredibly unfair to deny good-performing auditors within that firm the ability to continue to practise due to the conduct of one of their colleagues and this would also be very unfair and unsettling for audit clients.

34. It is not clear at all what the FRC has in mind by way of restitution. If it is suggesting that an audit firm might be ordered to repay some of its audit fee to its client, then this may work. However, if it is suggesting that it be entitled to order that an audit firm or audit partner pay restitution to third parties affected by the failures in audit work, this would be opening the door through regulatory sanctions to something which the High Court prevented happening many years in the leading case of Caparo v Dickman. It would also create all sorts of problems of proving damage and that the auditor's actions actually caused the loss. This could end up being an open-ended risk and many firms would struggle to obtain sufficient, or any, insurance to cover the risk. This might hasten the exit of more firms from audit work, including some

major firms, causing succession issues and decreasing competition. This would be a very troubling development.

Q12 The Sanctions Guidance in support of both schemes contains provision for a discount for admissions and/or settlement; see paragraph 57 to 61 of the Accountancy Scheme Sanctions Guidance as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions;

(a) Operating satisfactorily; or

(b) Inappropriate, and if so why?

35. We believe that it is a key part of any sanctions guidance for there to be provision for discount for early settlement. Such arrangements typically speed up a case and bring it to a quick conclusion, which is in the public interest, enhances confidence in the system, and is fairer on the miscreant.

Q13 Are there some sanctions which could be usefully imposed which are currently not available?

36. We have no comments to add here.

INDEPENDENT REVIEW OF THE FINANCIAL REPORTING COUNCIL'S ENFORCEMENT PROCEDURES SANCTIONS

ICAS' RESPONSE TO THE REVIEW PANEL'S CALL FOR SUBMISSIONS

Submission Date: 30 June 2017

ICAS is pleased to provide comments to the Review Panel in respect of the Financial Reporting Council's (FRC) use of sanctions through its Audit Enforcement Procedure.

Section 1 – Background to ICAS

With a Royal Charter granted in 1854, ICAS is the oldest professional body of accountants in the world. We were the first body to adopt the designation 'Chartered Accountant'. The designatory letters 'CA' are the exclusive privilege of our members in the UK.

We are a professional body for over 21,000 members who work in the UK and more than 100 countries around the world. We are proud that our CA qualification is internationally recognised and respected.

ICAS is an experienced and highly-respected regulator, with a wide and varied regulatory portfolio, including statutory delegated authority as:

- A Recognised Supervisory Body (RSB) for UK statutory company audit and local audit.
- A Designated Professional Body for incidental investment business (supervised by the FCA).
- A Recognised Professional Body for insolvency licensing and regulation (supervised by the Insolvency Service).

As a RSB, ICAS would like to make a positive contribution to the FRC's review of sanctions. We previously responded to a consultation in respect of the proposed Audit Enforcement Procedure in May 2016, and have otherwise engaged with the FRC more generally on enforcement matters for many years.

In responding to this Review Panel's request for information, we have taken account of our Royal Charter requirement to act in the public interest. We consider that the best way to protect the public interest in the context of sanctions is to ensure that the FRC exercises its powers in a way that is fair, proportionate, transparent, consistent, and otherwise in accordance with best practice.

If the FRC applies sanctions in accordance with these principles, it will also be acting in the best interest of regulated firms and individuals.

Consultation Questions

Question 1:

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

The objectives set out in the Sanctions Guidance and the Sanctions Policy reflect what would generally be considered standard practice across professional regulations. The Sanctions Guidance used by ICAS refers to the same broad objectives. As such, we have no recommendations for improvement (but see comments under Question 6 below).

Question 2:

Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Respondents are invited to state, for example, whether they think the Sanctions Guidance/Sanctions Policy are satisfactory and fit for purpose, and if not, why not, and how the Sanctions Guidance/Sanctions Policy should be improved. Respondents should state, for example, whether decision-makers should be provided with:

(a) guidance, either of the current or some other type;
(b) some form of tariff, possibly along the lines of the Guidance on Sanctions of the ICAEW; or

(c) *some form of guideline which divides regulatory offences into categories and prescribes a range of penalties having regard to the aggravating and mitigating features of the offence within the category.*

At present, the documents explain the sanctioning process, as well as the underlying reasons which support the approach. In this respect, they promote transparency, as well as some level of consistency of outcome.

Consistency would arguably be increased if the documents were also to set out indicative penalties for certain offences (whether by tariff, starting point, or some other method).

The Review Panel may wish to consider the approach which is adopted in Section 6 of ICAS' Sanctions Guidance – the document can be accessed on the ICAS website as follows: http://www.icas.com/regulation/complaints-information-for-icas-members

In our experience, it is very helpful to have indicative sanctions for particular offences. In addition to assisting those charged with determining sanction, it gives Members and complainers a reasonable expectation of the likely outcome of a complaint. Certainty is an important aspect of any regulatory regime.

Where adopting this approach (or something similar), it is important to emphasise that the sanctions listed are indicative only, with the decision-makers retaining absolute discretion to deal with offences on a case-by-case basis. This recognises that no two cases will be identical.

We accept that it may be more challenging for the FRC to adopt such an approach, given: (i) its more limited complaints jurisdiction, and (ii) the lower number of sanctions it applies. For indicative sanctions to be worthwhile, the offences would need to be sufficiently common and well-defined. It is for the FRC to decide whether it has a broad enough range of possible offences, but we would encourage the FRC to explore this initiative further.

Question 3:

In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

We refer to our answer to question (2) above, and would again make reference to approach set out in our own ICAS Sanctions Guidance. Once an offence has been made out, the Investigation Committee considers various 'relevant factors' which might be categorised as "aggravation" or "mitigation". This leads to an indicative order and financial penalty, which can then be raised or lowered on application of general mitigating and aggravating factors. The ICAS Sanctions Guidance applies at present to the Investigation Committee but the FRC Professional Oversight team have recommended that ICAS develop sanctions guidance for our Discipline Tribunal.

Question 4:

In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

In answering this question respondents are invited to explain (if either of these is their view) whether they think entities are dealt with too harshly compared with individuals or individuals too lightly compared with entities.

When considering audit complaints, ICAS will generally focus on the firm, although we retain the ability to also investigate individuals within the firm (usually the audit compliance partner or key audit partner). The focus of an investigation is something that will be depend on the circumstances

of the case. While the regulated entity will properly be held liable for deficiencies in firm-wide procedures, or breaches of the Audit Regulations, there will be circumstances where individuals 'go rogue', acting outside the scope of what would be reasonably contemplated by the firm.

As all sanctions should be determined in accordance with the objectives, there should be no reason or justification for entities or individuals being treated "*too harshly*" or "*too lightly*". If each is treated proportionately, it is inevitable that entities will receive higher financial penalties, with decision-makers taking financial resources and deterrence into account.

In the interests of transparency, it is perhaps only right to disclose that the RSBs perhaps have a vested financial interest in the decision to place a focus on entities rather than individuals – we fund the cases at present and there is a higher prospective of recovery of our costs where proceedings are raised against entities.

Proceedings against individuals are less likely to be defended unless underwritten by a third party (the costs of doing so will be prohibitive for some individuals), and the outcome is unlikely to influence future behaviours of an entity to the same extent (if that is the FRC's primary objective).

We consider that the FRC should continue to focus on entities, and individuals who are in a [senior] position of influence where their behaviour and conduct (commission or omission) has contributed to the outcome.

Question 5:

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

If respondents think that the FRC should establish some starting point, they are invited to articulate:

- *(a) how they consider that starting point should be measured for entities or individuals (e.g. by reference to specified monetary amounts, or a proportion of revenue, turnover, profit, audit fee, salary, income or something else);*
- *(b) how the starting point should be determined; and*
- *(c) what criterion/a should produce what starting point(s).*

The ICAS Sanctions Guidance does not currently provide different indicative financial penalties for firms and Members. However, we are reviewing the drafting to ensure that it is clear that entities are likely to receive higher penalties than individuals.

There is no easy way to establish a starting point financial penalty for an offence. This would need to be done in conjunction with other offences, to ensure that more serious offences generate higher financial penalties. The FRC would also need to review the penalties applied in previous cases; considering not only cases determined by the FRC, but also cases determined by other professional regulators, or in courts of law.

We would suggest that the starting point for the financial penalty should be considered separately from turnover, profit, fees etc. As these are factors that will vary considerably between members, fees, and cases, they would make it impossible to set a starting point financial penalty. Rather, these factors should be used to consider raising or lowering the financial penalty.

Question 6:

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

The sanctions currently available to the FRC are fairly standard and common amongst professional regulators. We cannot identify any obvious omissions.

Nevertheless, the presentation of the objectives would appear to give added weighted to deterrence, rather than delivering – first and foremost - a proportionate response to a breach of standards. ICAS has previously commented on this subject to earlier consultation papers.

There is no question that a sanction should serve as a message to the entity or individual that such behaviour or standards are unacceptable, but very few firms (if any) would set out to breach standards. Often the sanction that carries the most weight for firms will be publicity, which happens to be the default outcome of the penalty and costs orders. Firms are unlikely to want to attract the level of reputational risk that attaches to a sanction from the FRC, irrespective of what that sanction might be.

To that extent current sanctions - and the exercise of those sanctions - meet regulatory objectives.

Question 7:

In relation to financial penalties are they being set at the right level?

In answer to this question, respondents are invited to state:

(a) whether they think they are too low or too high, and
(b) *by what criterion or on what basis they are considered to be inadequate or excessive and to what extent that is so.*

ICAS held the annual meeting of our Public Interest Members on 23 June. We consulted with our PIMs on the importance of sanctions and fine levels in the context of public interest cases, providing an opportunity for debate and discussion on this key issue. Nearly 20 ICAS Public Interest Members attended the meeting, including three Public Interest Members of Council, two members of the Regulation Board , several members of the ICAS Investigation Committee, and lay members who sit on the ICAS Discipline Tribunal and ICAS Appeal Tribunal. ICAS Public Interest Members are independent of ICAS, and are charged with ensuring that the public interest is protected and given appropriate priority. Their feedback should be persuasive.

They consider that fine levels should be proportionate to the offence, should be of a level that could not be deemed immaterial to the firm or member concerned, but should not be disproportionate to the underlying breach. There is a risk of a disproportionate outcome if turnover is an overriding factor, or the default position is that financial penalties should be seen to inflict disproportionate financial loss for a firm). Our public interest members considered that whilst a sanction was necessary, publicity was often the most important outcome of any disciplinary process, and that such outcomes should be achieved by the regulator within a reasonable timeframe, which is capable of being reported without any risk of legal challenge on the grounds of unreasonable delay.

Separately, we understand that firms have been forewarned to expect to receive significant fines in the future. Whilst there may be cases where the departure from standards is so significant to merit a fine of that magnitude, such cases will be the exception. Putting aside any arguments about proportionality and fairness, a default position which considers that the sanction against an entity should be based first and foremost on its size and ability to pay, could have unintended consequences for the audit market.

Some firms could be influenced to review their client profile if the future risk/reward of such audit engagements is unappealing. A six figure audit fee is difficult to offset against a potential liability of eight figures. Insisting on disproportionately high financial penalties could force a consolidation of the PIE audit market. That would appear to be contrary to the desire to increase competition and market choice.

If there is a desire to impose significant penalties then this will also need to be factored into the way in which the FRC conduct investigations. Cases will need to be investigated much more quickly. There is little justification for imposing a significant penalty on a firm where the breach

occurred several years previously and the firm has made significant improvements of its own in the intervening period. There is no scope to argue that such a penalty in that case would change behaviours (if they have already changed), and if the passage of time has been very significant then there is unlikely to be anything left over from the material events to deter against.

Question 8:

If respondents think that financial penalties are too low is this because:

- *(a) failures of the type covered by the procedures require greater censure than is currently given;*
- *(b) they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;*
- *(c) they are insufficient to incentivise either high quality audit work/compliance with rules, regulations and standards;*
- *(d) they do not promote public confidence; or*
- *(e) some other reason?*

If there are any individual cases where financial penalties appear low, then it is acknowledged that the Tribunal will have had regard to all the relevant factors and exercised its judgement.

Question 9:

What are the key elements in achieving effective deterrence?

While effective and proportionate sanctions – including financial penalties – are clearly one way of achieving deterrence, their impact can be overstated. In our experience, the fact that all findings are publicised is a more effective deterrent. Members and Firms alike recognise the importance of reputational damage.

There are also various ways to achieve deterrence outside of enforcement processes; not least of which is making sure that professional ethics is a key part of the training syllabus. Enforcement ought to be the last resort. The FRC cannot create a profession or raise standards just through the imposition of heavy fines. The RQBs have a role to play in instilling the core values of our profession through our qualifications, and firms have a responsibility to continue to drive the cultural behaviours that are consistent with the fundamental principles of the profession.

ICAS launched the Power of One in order to promote the importance of personal responsibility, ethical leadership and influencing all those around you. Every CA is capable of being a force for good in their organisation. We will shortly amend our Code of Ethics to include reference to the need for our members to demonstrate “moral courage”, which we consider is an important and overarching fundamental principle.

Question 10:

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

This is quite a difficult question to answer. It would probably require some level of academic research to allow for reasonable conclusions.

Sanctions rarely “incentivise” good behaviours but they do communicate that such behaviours are not tolerated.

Sanctions are only one way in which public confidence is increased. The proximity between the material events and the imposition of the sanction is often many years at present – timescales need to be much shorter in order to truly promote public confidence.

Question 11:

Should there be greater use of non-financial sanctions such as:

(a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or
(b) an order for some form of restitution?

As ICAS is fully committed to the principles of developmental regulation, we would support greater use of non-financial sanctions by the FRC. The correct approach to sanction is to do no more than is necessary to remedy the concerns. If the underlying aims of enforcement (e.g. deterrence, protection of the public etc) can be achieved without financial penalties, this should definitely be considered.

Restitution should be treated with greater caution. The essential purpose of the FRC's enforcement processes do not support or require restitution, with plenty of other options available to complainers.

Question 12:

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

(a) operating satisfactorily; or
(b) inappropriate, and, if so, why?

The FRC will be better placed to assess how well these provisions are operating, as external bodies are not privy to the discussions which take place between the parties.

While ICAS does not offer discounts for admissions or settlement, acceptance of wrongdoing will be taken into account as a mitigating factor, and may lead to an order or financial penalty being reduced from the indicative level.

As settlement is now a fixture of many professional disciplinary schemes, it would be difficult to argue that it is inappropriate, per se. However, great care must be taken in the way in which settlement is discussed and agreed, ensuring sufficient oversight and transparency. The public interest will not be served if members of the publish believes concerns are being swept under the carpet in the interests of reaching an agreement.

Question 13:

Are there some sanctions which could usefully be imposed which are not currently available?

As noted above, the sanctions currently available to the FRC are fairly common amongst professional regulators, with no obvious omissions.

Response to Review Panel call for Submissions

The Institute and Faculty of Actuaries ("IFoA") Disciplinary Board ("The Board") welcomes this opportunity to provide comment to the Review Panel ("the Panel") on the Financial Reporting Council's call for submissions.

The Board has responsibility for the management and operation of the IFoA Disciplinary Scheme for members worldwide and has recently reviewed its own Sanctions Guidance. Whilst comparison between the two Schemes is of interest, the Board recognises that parity is not an aim of the FRC's review exercise. This is because the IFoA Disciplinary Scheme differs from the FRC's Scheme in significant respects. By illustration, two of these are:

- The FRC investigates cases involving members of the IFoA which raise or appear to raise important issues affecting the public interest in the UK. This different remit naturally has an impact on the levels of Sanctions imposed in the respective Schemes.

- The IFoA's Disciplinary Scheme has a different definition of misconduct to the FRC Scheme.

The Board have answered the questions following the order of your call for submissions. In addition, the Board would wish to make two general points:

1. The current FRC Sanctions Guidance state that the guidance applies to the FRC Disciplinary and Appeal Tribunals. The Board would recommend that this is extended to the Settlement Agreements that are determined in conjunction with a member and General Counsel of the FRC. This would provide clarity to those facing allegations that if a Settlement Agreement is the way in which a matter is dealt with the Sanctions Guidance still apply.

2. There may be Sanctions that are imposed by the FRC that have to be managed by the IFoA. It is important that the IFoA can implement the Sanctions imposed by Settlement Agreement or Panels. If there is any confusion or uncertainty as to this, it should be discussed with the IFoA before the Sanction is imposed.

We note the constructive and helpful working relationship between the FRC and IFoA executive staff in the most recent case, which illustrates this in practice.

Question 1

Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We assume for our purposes that references to "Sanctions Guidance" and "Sanctions Policy" refer to the November 2016 Actuarial Scheme Sanctions Policy for our purposes.

The Board is supportive of the objectives as set out in the paragraph 9 of the guidance. The principles of deterrence, protecting the public and maintaining and promoting public confidence in the profession are in line with principles of good governance.

The Board suggests that the Sanctions Guidance sets out an explicit commitment to the provisions of the Human Rights Act 1998 and the intention that the Sanctions Guidance is compliant with those principles, in the public interest.

Question 2/3

Is the Sanctions Guidance satisfactory and fit for purpose in current circumstances?

The current Sanctions Guidance is in the view of the Disciplinary Board fit for purpose at present. The Board is of the view that it could be a shorter document, with perhaps a table and/or flow chart to demonstrate how determination of Sanctions process should operate. However, overall the guidance is proportionate, reasonable and aims to uphold the public interest and the reputation of the profession.

In respect of the issue of tariffs, it is the view of the Board's that it is preferable to allow decision makers a wide remit to determine the appropriate level of Sanction. Each Tribunal, Appeal Panel or party to a Settlement Agreement are best placed to assess the seriousness and the facts of each case and should have a wide discretion to impose Sanctions that fit the severity of the misconduct. Imposition of minimum or indeed maximum tariffs could curtail that discretion and is not in the public interest.

The Board is strongly supportive of any guidance to expand on Sanctions policy approaches. For example, guidance can explain the regulatory presumption of exclusion from the profession in cases where dishonesty has been proved or admitted. Dishonesty, especially for financial services professionals is of the utmost seriousness and in order to protect the public and uphold the reputation of the profession where dishonesty is proved or admitted the Sanction should be exclusion or expulsion from professional membership. There may be a category of cases where the particular circumstances are such that the public may not regard dishonesty as a bar to continued membership. In such circumstances the Panel or Settlement Agreement must set the reasons for departure from the exclusion presumption with particular clarity.

Question 4

The Disciplinary Board has no comment on the Sanctions in respect of entities as the FRC's remit extends to the regulation of members of the IFoA, rather than firms.

Question 5/6/7/8

These questions relate to the imposition of financial penalties.

The Board is supportive in principle of the use of financial penalties as a way of marking the severity of a misconduct and acting as deterrence. Notwithstanding, the Board considers that it is important to protect the wide discretion of Tribunal/Appeal Panels to impose a fine that fits the extent of the misconduct, subject to the qualification that clear and full reasoning for any decision is transparent.

In determining a level of fine, the Sanctions Guidance can further provide clarification on the question of relevance of financial means testing, mitigation and extenuating circumstances.

Question 9/10

These questions relate to the aim of achieving deterrence, promoting public confidence and incentivising good behaviour.

The Board recognises the limits of Sanctions in this regard, as a mechanism that addresses established failures by individuals. However, it agrees with the FRC that these issues are nonetheless relevant and should be explicitly considered.

It is the view of the Board that the imposition of Sanctions, particularly financial penalties can help to achieve deterrence, but that can only be achieved when coupled with a transparent publication policy. The public, financial institutions and users of financial services must be aware of findings and the extent of Sanctions imposed.

Question 11
Should there be greater use of non-financial Sanctions such as:
(a) the imposition of conditions on practice
(b) an order for restitution?

The Board agrees with the policy of including supportive, training and/or educational Sanctions. In imposing non financial Sanctions the Panels or the parties to the Settlement Agreement must ensure that the Sanction can be managed. If any condition is imposed then the extent and nature of that condition must be clearly explained and care taken to ensure it can be complied with; if there is any IFoA responsibility stipulated in the Sanction it must be clearly documented.

Whilst the Board recognises that some regulators do include a compensatory or restitution element to disciplinary Schemes that they operate, this is not an approach followed by the IFoA. This policy decision reflects the fact that a "complainer" is not a party to the process, and is consistent with our overarching aim of the disciplinary process, being to pursue cases in the public interest and in the interests of the profession at large.

Question 12/13

These questions relate to the operation of current Sanctions Guidance.

Our experience of the Sanctions Guidance in force is naturally limited, given its recent publication, and we suspect that this question can be more fully answered by accountancy and audit consultees.

The Board suggests a minor drafting change to current guidance to make clear that a sanction can be imposed alongside another sanction, for example a fine alongside a condition on practice.

Conclusion
If the Panel have any questions in respect of the Board's response then please contact the Secretary to the Disciplinary Board.

Independent review of the FRC's Enforcement Procedures Sanctions

Response by Mike Kipling, FIA, member of the Tribunal Panel

I am responding in respect of the Actuarial Scheme, which I consider is largely satisfactory in its current form. In particular, it is materially congruent with the disciplinary scheme of the Institute and Faculty of Actuaries (IFoA), both with regard to objectives and sanctions. If any change was made to the Actuarial Scheme, the impact on the boundary with the IFoA scheme should be carefully considered.

Q1 to 3. I consider that the objectives of the Scheme are satisfactory. I do not believe that more detailed guidance on sanctions is necessary, although were it to be provided I am sure it would be of some assistance to tribunals and may result in greater consistency of decisions over time. It may well be appropriate to base any guidance or tariff on actual cases determined by tribunal, whether settled or taken the whole way. However, number of cases considered to date is very small and they provide little evidence on which to reliably base any tariff. Perhaps this step should be deferred until more cases have set precedents?

Q4. The Actuarial Scheme currently only relates to individual members. However, it may be worth FRC exploring with the IFoA whether their Quality Assurance Scheme (for firms) might in time extend to qualifying firms also being subject to the Actuarial Scheme.

Q5 to 8. At present, the Actuarial scheme may impose a fine only on an individual actuary. Where that actuary is employed by a firm, it is possible for the firm to indemnify the actuary not only against any fine but also against costs, both defence costs and the contribution demanded to FRC costs. Where this happens, the sanction becomes an indirect sanction on the firm and no sanction at all on the actuary. However, the size of the fine is based on the wealth or earnings of the individual actuary and is therefore 'chicken-feed' relative to the fine that might be imposed on a firm in its own right. This needs to be addressed, without increasing fines to excessively punitive levels for sole practitioners.

Public perception of a sanction which is, say, a reprimand and a fine paid fro by the employer may be as not much of a sanction at all and unlikely to deter others from behaving in a similar way in future. Behind the scenes, the stigma of the case might, of course, be a significant setback to the individual actuary's career. However, FRC cannot reasonably rely on this publicly.

Q9 to 10. In my opinion, there is quite a widespread lack of awareness amongst rank and file actuaries of the FRC's role and the Actuarial Scheme. After all, there has only been one 'conviction' in ten years and that only earlier this year. There is more awareness of the IFoA Scheme due to regular case summaries in *The Actuary* magazine. It is therefore probably going too far to say that the current sanctions under the Actuarial Scheme alone promote good behaviour, although both Schemes combined probably do.

However, I consider that a far stronger motivator is the professionalism work carried out by the IFoA, particularly the video case studies produced each year and promoted widely via the CPD programmes. One of these in the past featured a tribunal and a periodic repeat of something similar, perhaps in the joint name of the IFoA and the FRC, might get broad attention.

Q11. Only a relatively small number of actuaries need to hold a practicing certificate (PC), although these will mainly be actuaries in roles where any disciplinary breaches fall within the FRC scope. So suspension or withdrawal of a PC will often be an effective sanction, as it prevents the individual from carrying out a PC-requiring role for a period and this in turn may affect earnings and future career. Suspension of membership is in practice unlikely to have any great additional impact. Apart from some PC-requiring roles, actuaries can practice without being members of the IFoA, especially where they are employed in non client-facing roles in larger companies.

A restitution order depends on whether the disciplinary infringement resulted in loss. It may in any case be covered by an employer or professional indemnity insurance (assuming another regulator has not already required restitution). It may have some relevance where an individual customer of a sole practitioner would otherwise have no route to redress except perhaps via the Courts.

Q12. Personally, I do not particularly like discounts for settlement. I suspect that the general public might see it as evidence of the FRC/tribunal being a little too friendly to those found guilty of an infringement. The practice is clearly intended to encourage cases to be concluded more swiftly (although lower FRC costs might be sufficient incentive for this anyway) and may be appropriate.

I also think there may be a risk than an actuary would accept a reduced settlement and other sanctions for financial reasons before a case appears before a tribunal, when had the tribunal sat the outcome of the case may have ben in the actuary's favour. I'm not sure justice is done – even if it is apparently seen to be done – in this way.

I would personally prefer all cases to go tribunal, with a cap on the FRC costs which may be charged, which might encourage FRC and the other parties to expedite matters so that cases do not sit for so long over members' heads.

Q13. Consideration might be given to requiring actuaries convicted of technical malpractice to resit the relevant modules of the IFoA examinations. This would demonstrate that any learning requirements had been met and would actually act as quite a deterrent if it was seen to be applied from time to time.

14 June 2017

NOTE OF MEETING OF LEGAL CHAIRS ON 21 JUNE 2017 RE SANCTIONS

Present: Stanley Burnton, Kenneth Parker, Richard Gillis, Andrew Williams, John McGuinness, Terence Mowschenson; by phone: Richard Atkins

1. The general level of financial sanctions is too low. They are out of proportion to sanctions imposed by other regulators, in particular by the FCA.
2. We are concerned at the delay between the conduct that is the subject of proceedings and the tribunal hearing (and therefore the tribunal decision). The delay may be so long that the engagement partner has retired before the hearing. The result is that non-financial sanctions (exclusion, ineligibility, withdrawal of practising certificate etc.) are of no practical utility.
3. Nonetheless, dishonesty on the part of an accountant or actuary should always lead to a substantial period of exclusion. 10 years should normally be the minimum.
4. The EC should be more willing to make a complaint of Misconduct against management. The omission of accountant financial directors, for example, from proceedings against auditors, where there is reason to believe that management were as or more responsible as the auditors, gives an impression of unfairness or discrimination, which in turn affects the determination of sanctions against the auditors.
5. It is necessary to break the sequence of tribunal decisions, Executive Counsel submissions based on those previous decisions, and then further decisions that are constrained by both the previous decisions and the EC's submissions on sanctions.
6. The FRC Sanctions Guidance states that the primary purpose of sanctions is not punishment. However the distinction between the objectives listed in paragraph 9 of this Guidance and punishment is elusive. We note that the FCA refers to penalties as such: see DEPP 6.1. It is for consideration whether the express exclusion of punishment should be removed, and whether punishment should be included as such.
7. It is difficult, if at all possible, to give sanctions guidance similar to the sentencing guidelines issued by the Sentencing Council or the Criminal

Division of the Court of Appeal. It is not possible to identify a paradigm case or paradigm cases that be the subject of such guidance.

8. While the stepped approach in the Guidance may be helpful, it can and does lead to formulaic decisions. A Tribunal decision that imposes an appropriate sanction should not be liable to be overturned on the ground only that the 6-step process was not set out in the decision. Paragraph 16 of the Guidance is too prescriptive.
9. Some assistance may be derived from the approach of the FCA.
10. The starting point for financial sanctions should be disgorgement of the fee for the work that was the subject of the Misconduct, and any profit resulting from that Misconduct. Where possible, this should be by imposition of an order for repayment of the fee. Where this is impractical (as where the client has ceased to exist), the amount of the fee should be included in the starting point of assessment of the fine.
11. Where the amount of loss occasioned by the Misconduct can be ascertained, it is a highly relevant factor. However, care must be taken in cases in which there are or may be civil proceedings against the respondent to avoid double liability.
12. The losses risked by the Misconduct are similarly highly relevant.
13. The sums arrived at under paragraphs 10 and 11 above should be the subject of increase or decrease according to well-known factors listed under paragraph 16 of the Sanctions Guidance.

The Right Hon. Sir Stanley Burnton

2 July 2017

Comments to FRC sanctions consultation
from Tania Brisby, Lay Tribunal Panel Member since December 2013

Question 2
Setting Tariffs

- I have sat on 1 case and am scheduled to sit on a further 2. The issues involved in the alleged or proven misconduct, as well as the degree of dishonesty involved are so very different that I would be concerned that setting tariffs is impractical.
- I believe there is a risk that fixed tariffs might have an unintended consequence of influencing Tribunal Panel findings as to misconduct, reprimands or severe reprimands.

Question 4
Sanctions on firms vs. individuals

- I think individuals are dealt with lightly compared with firms, and believe that strengthening sanctions against individuals will have a beneficial effect in terms of encouraging professionals in firms to withstand the pressure to cut corners, save costs or avoid difficult issues with valuable clients.
- Heavy penalties against firms may increase a 'box ticking' approach to enhanced compliance but are unlikely to help deter or deal with bad (or incompetent) apples.

Question 7
Level of penalties

- I find it surprising that more cases are not settled without going to Tribunal. It is arguable that establishing higher penalties for cases where misconduct is found after a Tribunal hearing would encourage firms to settle early – conversely, in partnerships, as opposed to listed companies and banks, it may be that raising penalties will just lead more firms to take cases to Tribunal, Appeal or Judicial Review.

Question 9
Deterrence

- As a former investment banker, I think a key element in achieving deterrence is maximising the embarrassment and publicity around misconduct findings.

Question 11
Non-financial sanctions

- As a company director who sits on audit committees, I would be gravely concerned by any move to disqualify the large firms (PWC, KPMG, Deloitte and EY) or their practice areas (as opposed to individuals). There is little enough choice anyway when selecting auditors as not all of the big 4 have specialist knowledge/ track record in all business sectors. Disqualification would have a disastrous effect on competition, and smaller firms simply cannot offer clients the same service as these global players.

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Noranne Griffith
Committee Secretary
Corporate Division
Financial Reporting Council

(By email only to
enforcementproceduressanctionsreview
@frc.org.uk)

Date: 13 Jul 2017

Dear Miss Griffith

Financial Reporting Council - independent sanctions review

Thank you for inviting The Pensions Regulator to respond to the FRC's call for evidence on its Sanctions Guidance and Policy. We note that you have considered relevant TPR material as part of the policy review including our Compliance and Enforcement policy. We would refer you to our recent "Draft monetary penalties" consultation document where we set out in some detail our current thinking on this issue. That consultation document is available at: http://www.thepensionsregulator.gov.uk/doc-library/draft-monetary-penalties-policy-and-revised-professional-trustee-description-consultation-2017.aspx.
That consultation has now closed and we are considering the responses which we received. We will make any appropriate changes before publishing the final monetary penalties policy.

Questions in the consultation and TPR response

Question 1
Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

TPR comment – We understand FRC's existing objectives to be deterrence, public protection and to maintain and promote public and market confidence. We note that punishment of wrong doing is not a stand-alone objective. Punishment of wrong-doing is one of the objectives that TPR has when imposing monetary penalties under pensions legislation (including section 10 of the Pensions Act 1995 and regulation 28 of the Occupational Pension Schemes (Charges and Governance) Regulations 2015). Whilst it is not necessarily a primary purpose of the FRC's Sanctions policy, we consider it

appropriate to identify it as an objective, particularly for more egregious examples of wrongdoing.

Question 2
Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

TPR comment – The existing Sanctions Policy is a public document stating the FRC's approach. It sets out the objectives of the policy in an appropriate transparent manner, identifying key factors which will be taken into account. It appears to us to strike a balance between being informative without being unduly prescriptive.

Question 3
Would a tariff be appropriate?

TPR has proposed a form of tariff for the financial penalties which it may impose. It is proposed that there would be 3 band levels within the penalty framework according to the nature and impact of the wrongdoing. We have identified aggravating and mitigating features which would cause a penalty to be nearer the top or bottom of the band.

In some of TPR's work Parliament has legislated on the precise level of penalties (for failure to comply with employer duties under Automatic Enrolment for example); this will not always be possible in a more flexibly regulated environment.

Question 4
In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

TPR comment – Much of the pensions legislation for which TPR has regulatory responsibility operates statutory limits on monetary penalties, which are generally £5,000 in the case of an individual and £50,000 in any other case (eg a body corporate). Accordingly whilst we take a proportionate banded approach to financial penalties, the starting point for corporate entities will be higher, which reflects the approach of Parliament to wrongdoing in the regulated community.

Question 5

In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

TPR comment – As noted above, TPR is proposing to introduce a banded penalty framework policy which we consider to be transparent. An understanding of the starting points FRC use could assist the regulated community understand the parameters of FRC sanctions. Penalties should be commensurate with the wrongdoing. In the area of Automatic Enrolment all non-compliant employers are issued with a Fixed Penalty in the sum of

£400; should the employer continue to be non-compliant, they would receive an Escalating Penalty which accrues at a daily rate according to the size of the employer, ranging from £50 to £10,000 determined by the size of the employer.

Question 6

To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

TPR comment – The current range of sanctions available (e.g. waiver or repayment of client fees, reprimand, financial penalty, prohibition orders, mandatory announcement etc), which can be used flexibly and in combination, appear to provide a wide choice to decision makers to impose the appropriate sanction according to the impact of the wrongdoing and degree of responsibility of the respondent.

Questions 7 and 8 relate to the level of financial penalties;

TPR has no comment on the particular level of penalties other than to observe that the fine should act a deterrent, promote public confidence, punish wrongdoing and help achieve the FRC's other stated enforcement objectives

Question 9

What are the key elements in achieving effective deterrence?

TPR comment – A mixture of factors including consistency, effectiveness and visibility. TPR use communications extensively, to achieve visibility with our regulated community, and this is likely to be key for FRC's regulation of a professional community. TPR seeks to call-out wrongdoing where we have come across it and publish detailed reports to be as transparent as we can be about our regulatory work.

Question 10 and 11

Do current sanctions in fact promote or incentivise good behaviour and promote public confidence? Should there be greater use of non-financial sanctions?

TPR has no comment on these questions.

Question 12

The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; are these provisions operating satisfactorily; or inappropriate?

TPR comment – These provisions are likely to be appropriate in certain cases and ensure a degree of proportionality which is a staple of good regulation. We value co-operation and self-reporting in our regulatory activities. We expect the regulated community to engage with us and accept responsibility where they have got things wrong. We would typically treat these as mitigating factors when it comes to setting the level of penalty.

Question 13

Are there some sanctions which could usefully be imposed which are not currently available?

TPR comment – The range of available sanctions appears to us to be suitably wide and can be used in combination. The range of sanctions appears to be adequate and can be used flexibly to achieve the regulatory aims.

If you require clarification of any of these points, please feel free to contact us at the address provided.

Yours sincerely

The Pensions Regulator

Email: carl.dowling@tpr.gov.uk