CIPFA The Chartered Institute of Public Finance & Accountancy

CIPFA's response to:

AADB consultation on Sanctions Guidance

July 2012

the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

RESPONSE TO AADB'S SPECIFIED QUESTIONS

1. **Do you agree with the Board's objectives and approach to sanctions guidance?**

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

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

CIPFA has no concerns about the AADB's overall position, in terms of its statement of the principles that apply to sanctions for professional misconduct and the purpose being pursued by the scheme and the Guide.

Sanctions Guides are a widely recognised tool for achieving the aims articulated by the AADB Board.

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

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

Please refer to CIPFA's detailed comments on the draft Indicative Sanctions Guidance below.

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

7. **If so what adjustment do you consider to be appropriate?**

CIPFA is in broad agreement that the factors set out at paragraphs 4.9 and 4.10 of the consultation document demonstrate a need to review the policy and practice on fines imposed by the AADB. Our detailed comments on the AADB proposals are contained in our comments on the draft Indicative Sanctions Guidance.

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

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

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

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

Please refer to CIPFA's detailed comments on the draft Indicative Sanctions Guidance below.

COMMENTS ON THE DRAFT INDICATIVE SANCTIONS GUIDANCE

General

Underlying CIPFA's comments is a general observation that the AADB's position appears to be very much driven by its experience of dealing with cases involving large accountancy firms with extensive audit practices. This is indicated through the examples given in the Guide itself and in the rationale for the proposals. To some extent this is inevitable, given the nature of the most significant cases dealt with in the last few years. However, the Guide needs to be appropriate across the different types of case which may be considered under the Scheme over the coming years, including cases involving public sector finance, and the likely different circumstances of individual Members in those cases. Please see below for comment on individual elements of the Guide where we consider this to be a potential issue.

Approach to determining sanction

This is set out in paragraph 22 of the Guide. Each of those steps is clearly necessary, and the requirement for an explanation of the approach taken on each of those five steps is very important and helpful.

However, we question how easy it will be to apply those steps and whether they provide sufficient structure. Under the CIPFA Sanctions Guide, Committees are encouraged to start with the least serious sanction and consider whether it is appropriate to reflect the seriousness of the misconduct in the case, only moving up to the next sanction if they determine that it is not sufficient as a sanction to reflect the seriousness of the misconduct found proven. This provides an anchor or reference point for the Committee's assessment of the seriousness of the misconduct and guards against inappropriate inflation of sanctions.

We have the following concerns about the AADB approach:

(1) It indicates that Tribunals should make an assessment of the seriousness of the misconduct and then to add or subtract from that level of seriousness without linking this directly to a specific sanction – this leaves Tribunal members holding a lot in their head, and involves dealing in rather abstract notions of "seriousness" rather than concrete representations of seriousness in the form of specific sanctions. This also seems contrary to what is envisaged at paragraph 4.1 of the consultation, where reference is made to assessing seriousness, in the first instance, in order to identify a "starting point".

(2) It indicates that Tribunals should select the sanction that seems most appropriate from within the range available, without requiring them to work through them systematically and justify the selection of more serious sanctions. We appreciate that the AADB cases involve more serious allegations, but of course we can't assume the level of misconduct that will be found proved in respect of any one individual – and arguably there is a particular need in this context to avoid inflation of sanctions on the basis that the case must be serious if it ended up before an AADB Tribunal.

We suggest that the AADB approach may be more appropriate and less open to error/practical difficulty if it were amended to include the wording in bold as follows:

i. Assess the nature and seriousness of the misconduct **found by the Tribunal** (paragraphs (24) to (47)).

ii. **Identify the sanction or combination of sanctions which the Tribunal considers appropriate to the misconduct as assessed in itself under i. above. The Tribunal should start by considering the lowest**

sanction. If that is considered insufficient to reflect the seriousness of the misconduct (either in itself or in combination with other available sanctions) the Tribunal should consider the next most serious sanction, and so on until they reach a level of sanction which they regard as proportionate to the seriousness of the misconduct.

iii. Consider relevant aggravating or mitigating circumstances **and how they affect the level of sanction that would be appropriate** (paragraph (48)).

iv. Consider any further adjustment **to the level of sanction which is appropriate** for deterrence (see paragraph (49)).

v. Consider whether a discount for admissions is appropriate (paragraphs (50) to (56));

vi. Decide which sanction(s) to order and the level/duration of the sanction(s) where appropriate; and

vii. Give an explanation at each of the **six** stages above, sufficient to enable the parties and the public to understand the Tribunal's conclusions.

This additional wording would seem to fit well with the way in which the Guide is set out, with detailed guidance on the types of cases/misconduct for which individual sanctions are likely to be appropriate.

In addition, we question whether the order in which certain sections appear in the Guide is appropriate and completely consistent with the suggested approach to determining sanctions. Logically, and to fit with the approach laid out above, it seems that any general guidance on the nature and seriousness of misconduct should appear before discussions about when individual sanctions may be appropriate. This would mean moving paragraphs 46 to 47 to after the current paragraph 22, before the guidance on individual categories of sanction.

It is also notable that the Guide gives a very limited amount of guidance on assessing the seriousness of misconduct generally (as opposed to assessing whether individual sanctions may be appropriate/the level of a particular sanction to be imposed). We suggest that it would be appropriate and consistent with the approach for determining sanctions which is laid out above to set out a summary of the factors which are regarded as relevant generally to the assessment of the seriousness of misconduct. Listing these factors only in relation to individual sanctions would seem to increase the risk that Tribunals will link these factors automatically to specific sanctions rather than using them to assess seriousness in itself and then separately addressing the question of which sanction or combination of sanctions is then proportionate to misconduct at that level of seriousness. It increases the risk that Tribunals will enter the sanctions ladder at the wrong level rather than starting at the beginning and working up to the highest appropriate level of sanction.

Severe Reprimand

Para 17 of the Guide states that "If the seriousness of the misconduct is such as to merit a Severe Reprimand, then it will normally be appropriate that it be ordered in conjunction with another sanction", e.g. a fine. This seems rather prescriptive. Surely it is logically possible for the Tribunal to conclude that the conduct is such as to merit a more severe indication of disapproval, but to conclude also that in the circumstances additional sanction is not appropriate? If the AADB wants to make a statement of this

nature, it might be better worded as a suggestion that "If the seriousness of the misconduct is such as to merit a Severe Reprimand, then it will normally be appropriate for the Tribunal to consider carefully whether another sanction should also be ordered in conjunction with the Severe Reprimand".

Fines – general approach

The clear intention is that Fines will be a key element in the sanctions regime. In addition, the AADB expressly indicates that it believes that the level of fines imposed by its Tribunals should be greater than those imposed in the past.

These principles are not objectionable in themselves. The public are perhaps particularly likely to see financial sanctions as an appropriate reflection of the seriousness of misconduct and the need to deter misconduct in cases with financial implications, and even more so in cases about the conduct of members of large commercial accounting practices which are likely to have gained financially from their activities.

However, we do have a concern that all of the examples given in the consultation document to explain the AADB's approach refer to the size and scope of work undertaken by large accountancy firms, the scale of their fees etc. There is no consideration within the proposed Guide of other types of case which may come before the AADB, e.g. those involving accountants working in the public sector rather than for large commercial accountancy practices. It is therefore not clear on the face of the Guide that in adopting these principles on fines the AADB has taken account of the full range/type of cases and Members which may come before its Tribunals and ensured that its approach is relevant and appropriate to all of them.

It is the case that the Guide requires the Tribunal to consider the impact on the Member before reaching a decision as to the appropriate level of a fine. This would enable a Tribunal to take account of the fact that a CIPFA Member working in the public sector might well have significantly lower means than a senior employee or partner of a large accounting firm. However, specific examples of conduct given in paragraph 31 (guidance on assessing the nature and seriousness of misconduct to determine the level for a fine) relate to private practice work and there are no clear examples which specifically relate to public sector finance practice. This may make it more difficult for Tribunals to assess the seriousness of misconduct in such cases. We would suggest that: the first and second bullet points of paragraph 31 in particular would benefit from an additional broader/public sector example; the final bullet point should refer to "or organisation" rather than just to "the firm"; in bullet point 11 it might be appropriate to refer also to undermining confidence in public sector accounting and/or other potential implications of significant failures by public sector accountants; and finally, that this paragraph should include a further bullet point that refers to whether the Member held any statutory or other appointments (such as being the appointed officer under s.151 of the Local Government Act 1972) which mean that there are particular issues about public confidence in those appointments.

In addition, in terms of overall policy the AADB may wish to consider how this different type of case might affect public perceptions and whether the emphasis placed on fines may have negative effects in some circumstances. If significantly lower financial sanctions follow from misconduct in the public sector than in comparable cases involving the private sector (both because of the lower means of the individual Member(s) concerned and because there is no Member Firm involved), will the public regard the outcomes as inconsistent or will it create the impression that the public sector case is less serious? If there was more emphasis on exclusion from professional membership or practice as being a core sanction/the most serious sanction, with fines as an additional sanction available in relevant cases, it might be easier to demonstrate a consistent

approach/level of censure across all cases. We consider this could be achieved whilst maintaining fines as a key element of the sanctions regime.

Fines – the specific options

We note that the AADB is clear that the intention is that each of the three mechanisms would achieve "roughly" the same level of change in the level of fines applied. The question to consider must therefore be which of the mechanisms will do the best job of ensuring a proportionate link between the amount of a fine and the seriousness of the misconduct and enabling the Tribunal to fulfil its legal duties fairly.

Each of the options is expressed rather prescriptively. The use of indicative sanctions in this kind of guidance is quite common and in itself unobjectionable, but it is important that this is done in the context of clear statements about the existence and importance of a Tribunal's overall discretion to impose the sanction it considers to be appropriate and proportionate to this particular case. We consider that the proposed Guide does not do this sufficiently clearly, and therefore is at risk of encouraging Tribunals to lose sight of their discretion and take an approach to calculation of fines that is too mechanistic.

We suggest that paragraphs 28 and 29 of the Guide, which set out the overall basis on which fines should be determined, would be an appropriate place to emphasise ultimate discretion. In addition, we note the prescriptive language used in the third sub-paragraph of paragraph 32: "where the Tribunal considers that revenue is an appropriate indicator of the Member Firm's size and financial means, the Tribunal should determine a figure which is based on a percentage of the Member Firm's annual group turnover...". Although the following two paragraphs do indicate that there is a discretion as to the percentage of the turnover to be applied, there is a strong encouragement to use the prescribed starting point and there is no express reminder here that ultimately the level is in the discretion of the Tribunal. The same point arises in relation to paragraph 33, on calculating the level of fine to be applied to an individual Member. Such a reminder of the Tribunal's discretion should be included in the Guide, preferably both in the specific guidance in paragraphs 32 and 33 and in paragraphs 28 to 29, but certainly in one or the other location.

As regards the three options, we will comment on each of them in the context of both Member Firms and individual Members. However as an overall comment it is quite difficult to comment on how suitable each mechanism is in terms of fairness and ensuring that the sanction can reflect the seriousness of misconduct when no figures are given as to the percentage figures to be used to calculate the fines. Without such a starting point for comment, a large range of possibilities has to be considered.

Option 1: Percentage of Member's financial means, indicative minimum level

In respect of both Member Firms and individual Members, we are concerned about setting a lower threshold for a fine without reference to the seriousness of the misconduct in the particular case. Again, at this point it is crucial to note the difference between the threshold of seriousness/public interest that has to be met before allegations are passed to the AADB and the actual level of misconduct that is ultimately proved before the Tribunal. The Guide as currently drafted allows for the level of fine to be altered from the starting point by reference to mitigating or aggravating factors, but not by reference to the level of seriousness of the misconduct itself. This problem could be at least partially resolved by an explicit recognition in the Guide that the Tribunal retains a discretion to go below the minimum and consideration of when this may be appropriate.

Member Firms: "Turnover" is usually to be used as the reference point for financial means for Member Firms. CIPFA does not feel able to comment on the suitability of the

proposed definition, but it is obvious that the definition needs to be appropriate and properly reflect the financial resources/strength of the Member Firm if the scheme is to operate fairly and proportionately and have credibility with members. While the Scheme acknowledges that revenue may not always be the appropriate indicator, it provides no real guidance on when that will be the case. Coupled with the certainty offered by percentages of turnover, we would be concerned that this will encourage Tribunals to use turnover in all but the most obviously inappropriate cases. The definition of turnover will require the Tribunal to enquire quite closely into the corporate structures of the firms, which seems likely to generate extensive argument (and legal costs) in itself – though this may be unavoidable.

Individual Members: Financial means are to be assessed primarily through the Member's remuneration. Clearly remuneration has to be a key element in assessing means, but in our view it would be more appropriate to refer to his financial resources generally, encompassing remuneration for the professional role but also other assets and income (particularly given the reference to the need for the size of the Fine to act as a credible deterrent). In addition, the Guide focuses solely on income and does not refer directly to the impact on income/resources of expenditure/financial commitments and dependents. This may undermine the aim of ensuring a consistent impact of financial sanctions on defendants.

We would also query whether the focus on the income in the year immediately preceding the finding of misconduct is appropriate, given that this may not be representative of the Member's overall financial circumstances and income over the course of his career (particularly e.g. if his career has been affected by the matters giving rise to the conduct proceedings). The lack of a future income may well be relevant to his overall resources, but may not give a complete picture of his financial resources. As with Member Firms, the Guide references the possibility that income will not be the appropriate indicator but does not provide guidance on when this might be (other than for a Member who has retired/ is not in employment) and how to assess resources in that situation.

Option 2: Percentage of financial means, five indicative levels

To a large extent this mechanism shares the problems of Option 1, because it still involves stating a minimum starting point. However again this could be tackled by a more explicit recognition of the overall discretion on the Tribunal.

The comments on option 1 as regards turnover and income/remuneration apply equally to this option.

CIPFA considers that the use of five indicative levels with ranges for each one is potentially helpful. Particularly in light of the stated intention to increase the levels of fines, providing indicative ranges for different levels of seriousness may help to avoid fines becoming disproportionately inflated, ensure greater consistency and assist Tribunals in explaining their decisions. However it is difficult to comment without knowing what the percentages would be which apply to each level. Furthermore, a range for each level may be more appropriate than a single percentage – or else it needs to be made clear whether the single percentage is the bottom end of that level or the average/mid-point, i.e. the likely appropriate figure for the average case within that level of seriousness.

As a point of detail, the Guide refers to an overall range of between x% and y%, but does not in terms explain how those figures relate to the figures a% to e% which are linked to the five levels of seriousness. Is a% the same as x%, or is a% the figure for an "average"/mid level 1 case, with x% being slightly lower to reflect the least serious case possible?

Option 3: Percentage of financial means up to maximum figure

Again, comments above on the definition of turnover/means/income apply equally here.

We understand that a maximum can be used to place a ceiling on liability and effectively calibrate figures used for cases below the maximum level of seriousness. However a maximum percentage of income is rather less easy to understand than a simple maximum figure. The disadvantage of this option is that it gives little guidance on how to apportion fines at different levels of seriousness, compare option 2.

Overall

It is appropriate to link sanctions directly to the resources of defendants to ensure that the sanctions have the same sort of impact on different defendants. However a disadvantage of this approach is that it is perhaps less readily understandable by the public and may lead to what appear to be wide differences in the financial penalties imposed on different defendants, because the amount of money involved will be very different. Furthermore, it is difficult to set out such explicit indicative figures without discouraging Tribunals from properly exercising their wide discretion. However each of the options above might look more acceptable in the context of a greater emphasis in the Guide on the Tribunal's overall discretion.

Fines and Costs Orders

Paragraph 4.21 of the consultation document refers to the Tribunal's power to order Member or Member Firm to pay AADB's costs (in whole or in part). It indicates that Tribunals' decision on fine should not be affected "on the basis that the Member would be ordered to pay significant costs to the AADB". Tribunals "should decide the sanction to be imposed independently of any costs it might consider awarding" and "costs should not be a factor in determining the level of a Fine". The reason given for this approach is that the deterrent effect would be diluted if the level of fines were to be reduced to take account of the financial burden of a costs order.

We agree with this to the extent that it is simply a statement that a decision should be taken on the level of fine appropriate as a sanction for particular misconduct and that potential costs orders should not form part of this assessment. However if this is saying that Tribunals should take two different decisions on fines and costs without reference to the total financial burden being imposed on the Member, then this may be problematic. We believe the correct approach, legally, is for Tribunals to consider the total financial impact of their decisions and the ability of the Defendant to meet both fine and costs order. We would therefore be concerned that the AADB approach may lead to challenges by Members.

We also consider that the Guide should cover costs and explain how Tribunals should take account of the overall impact of fines and costs orders.