ACCOUNTANCY AND ACTUARIAL DISCIPLINE BOARD
RESPONSE TO FRC CONSULTATION PAPER DATED
APRIL 2012

"SANCTIONS GUIDANCE TO TRIBUNALS"

1 Introduction

1.1 This Response is given on behalf of Wragge & Co, a UK-headquartered international law firm providing a full range of legal services to clients worldwide. As at 1 May 2012, the firm has 125 partners, supported by more than 1,100 people from Wragge & Co LLP offices in Birmingham, Brussels, Guangzhou, London and Munich, plus affiliated offices in Abu Dhabi, Dubai and Paris. Its broad client base spans everything from FTSE 100 and 250 companies and multi-national corporations, to financial institutions and hundreds of public sector organisations.

1.2 Wragge & Co is happy for its comments to be a matter of public record.

2 Response to questions raised in the Consultation Paper ("the Paper")

2.1 **Q1: Do you agree with the Board's objectives and approach to sanctions guidance?**

A summary of the purpose for which AADB sanctions are imposed is set out at paragraph 3.5 of the Consultation Paper, namely:

- To protect the public from Members and Member Firms whose conduct has fallen short of the standards reasonably to be expected of Members and Member Firms;
- To maintain and promote public and market confidence in the accountancy profession and the quality of corporate reporting;
- To declare and uphold proper standards of conduct amongst Members and Member Firms; and
- To encourage high standards of conduct amongst Members and Member Firms.

2.2 As statements of principle, the Board's objectives are to be commended and we do not take issue with them. However, as stated in paragraph 3.6 of the Consultation Paper, and as confirmed by the Supreme Court in *R (On the Application of Coke-Wallis) v The Institute of Chartered Accountants in England and Wales,* the primary purpose of sanctions in a disciplinary context is not to punish but to protect the public interest. Accordingly, we do not consider it a *necessary* ingredient of any new regime that the fine element of the determination by the Tribunal should be punitive. That said, it should be sufficient to both deter conduct of the sort under consideration and promote public confidence in the profession and the disciplinary framework. In other words, its impact needs to be felt but without jeopardising the financial viability of firms (save perhaps in cases of 'Level 5' conduct).

2.3 We agree that there should be sufficient clarity at the outset of the process for all

parties to respond (and be encouraged to respond) in an appropriate manner which neither lengthens or over-complicates an already highly detailed investigative process.

Q2: Do you agree that Tribunal needs a clear framework for sanctions which reflects the nature of its cases and the wider context in which the accountancy profession operates today?

2.4 Given the wide range of circumstances that fall within the remit of the AADB, we agree that whatever guidance is issued should be sufficiently flexible to cater for that diversity. As such, we agree with the Board that a principles based approach (rather than a more prescriptive 'rules' based approach) would be more likely to achieve the stated aims of the scheme.

2.5 The framework within which the AADB operates should not be so prescriptive (in terms of either procedure or outcome) that the ability of the Tribunal to 'flex' its approach is removed.

Q3: 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?

2.6 As far as proportionality is concerned, we consider that the greatest weight should be given to ensuring that any sanctions/fines are proportionate to the conduct under investigation, as opposed to the perceived resources of the Member/Member Firm that is the subject of the enquiry.

2.7 We disagree with the point made at paragraph 4.10 of the Paper, namely that the current environment does not adequately incentivise the right kind of behaviour amongst Member Firms. We have been working with members of the Accountancy profession for many years. Certainly as far as the larger firms are concerned, the management of reputational risk has been at the top of their agenda for at least the past 20 years. Both the competitive environment in which these firms operate and the claims environment combine to ensure that quality is (and will remain) the overriding priority for the profession. As James Chalmers, UK Head of Assurance at PwC was recently quoted as saying in Accountancy Age: *"Quality is at the very heart of what we do: it is essential to our reputation, important to the work that we undertake for our clients and is a fundamental strategic objective for the firm"*; words that would no doubt be echoed by a broad spectrum of firms both amongst the Big 4 and beyond. Accordingly, one cannot simply say that increasing the overall level of fines would lead to any material change in the way the major firms (already) operate. That being so, there is a risk that any move to increase the overall level of fines might be cynically viewed as an attempt to raise further funds for HM Treasury, rather than cure a 'perceived' problem relating to inappropriate procedures and/or conduct by Member Firms. That said, we do agree that the imposition of a monetary sanction will be appropriate in many cases. 'Punitive' awards should, however, be reserved for those cases of deliberate or dishonest conduct. Irrespective of resources, punitive awards have no place, in the context of conduct that is merely inadvertent and/or where no actual monies have been lost or put at risk.

2.8 As far as quantification is concerned, we do not agree with the Board's view (as set out at paragraph 4.16 of the Paper) that group turnover is an appropriate method of measuring size and market power (and is therefore a suitable basis for

calculating fines on Member Firms). As some of the firms in the Top 20 league table already graphically illustrate, turnover may not necessarily reflect ability to pay. A firm half the size of another could enjoy higher levels of profitability and thus, be better placed to meet a higher level of fine than the firm whose turnover is high but whose profitability is (in relative terms) low. It follows that we do agree with the statement at paragraph 4.18 of the Paper, namely that 'Tribunals should not impose manifestly unreasonable penalties of a scale that will have a devastating and unjustifiable impact on the Member or Member Firm and its business'. This factor needs to be given appropriate weight by the Tribunal in its deliberations.

2.9 As far as admissions/offers of settlement are concerned, there is a risk that if the level of fines reach punitive/commercially harmful levels, Members or Member Firms may feel pressured into making premature and/or inappropriate admissions. This could be as damaging to the perceived 'fairness' of the process as a system where there is no encouragement for early settlement/admissions to be made.

Q4: Have we included the sorts of factors in the sanctions guidance that you would expect to see taken into account by Tribunals?

2.10 Yes, the factors set out in the Paper are those one would expect to fall for consideration by the Tribunal. However, as the Paper highlights, it is a question of attributing appropriate weight to the different factors on a case by case basis. We certainly agree that the seriousness of the offence (particularly whether it involves deliberate or dishonest – at one end of the spectrum - or isolated and inadvertent conduct at the other) should be the primary factor in determining what sanctions are imposed. Whilst the other factors cited, such as applying a discount for early settlement/admissions and ensuring that mitigating factors and the need to have a deterrent effect are taken into account, one needs to remember that deterring is different to penalising. The accountancy profession is already bearing a huge time (and therefore cost) burden in dealing with compliance and regulatory matters. In the current climate, both Government and regulators need to be mindful not only of the public interest in ensuring that misconduct is appropriately addressed but also the public interest in ensuring that a profession which performs a central role in sustaining public confidence in our financial markets is not harmed by unwarranted additional financial and regulatory burdens.

Q5: Are there any factors you believe Tribunals should take into account when deciding sanctions that we have overlooked?

2.11 No. Provided the guidance remains principles based and flexible, it should be capable of taking into account a wide range of factors in any event.

Q6: Do you agree that there needs to be an adjustment in the level of fines imposed in AADB cases?

2.12 Yes, but only where the conduct warrants it. 'Headline grabbing' fines should be reserved for those cases where the misconduct is deliberate or dishonest or involves a breach of integrity that is neither isolated or trivial in its impact (or potential impact).

2.13 We do not necessarily agree that whether the conduct caused actual harm (or created a risk of serious harm) should be a mitigating factor in relation to intentional conduct. After all, criminal sanctions for attempted theft or attempted murder are very similar to those awarded where the actual offence is committed,

and rightly so. We also consider that the overall costs to be awarded against the Member and/or Member Firm should be taken into account when deciding the overall level of fine. If the focus is on deterrence, it is the *overall* financial impact on the Members or Member Firm that should be assessed.

Q7: If so, what adjustment do you consider to be appropriate?

2.14 As noted above, we consider that there is justification for increasing the overall level of fines in the most serious cases. Provided the motivation for doing this remains the building of public confidence, any increase to the level of fines should not extend to many multiples of those awarded under the current system and should not, in our view, be based on the turnover of the entity under investigation.

Q8: What is your view of the alternative mechanisms proposed for calculating fines?

2.15 It is apparent from our comments above that, of the alternative mechanisms proposed, we would prefer to see the adoption of the proposal that aligns the level of fine to the seriousness of the misconduct, utilising a sliding scale of the sort proposed.

Q9: What level of turnover/income do you consider would be appropriate in respect of each mechanism?

2.16 As also noted above, turnover (in isolation) is not in our view the most appropriate criteria to use. The seriousness of the conduct under investigation should remain the primary factor when determining the overall level of the fine. Turnover is 'a' relevant factor but it should remain a secondary criteria. Fines should be credible, not punitive.

Q10: 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?

2.17 Not necessarily. We consider that material costs should be taken into account in substantial cases (see 2.13 above).

Q11: Do you have any other comments about the proposed structure or content of the sanctions guidance?

2.18 In addition to the issues outlined above, we are also concerned that the changes proposed in the Paper could result in a far more adversarial, time-consuming (and hence costly) investigative process than under the current regime. If Member Firms were faced with the prospect of life threatening fines, this will not only be potentially damaging to their business (and the profession) in the long term, it could also result in unwarranted/premature admissions being made as firms seek to mitigate the financial impact of an investigation. These factors may not necessarily enhance public confidence in the profession or those charged with its oversight. Prior to implementation of any changes, we would also like to see evidence(perhaps based on the experience of comparable regulatory and disciplinary bodies in other jurisdictions)that changes of the sort being proposed do actually help to achieve the purposes set out at 2.1 above.

Wragge & Co

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