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Dear Ms Colban

Consultation document: Sanctions guidance to Tribunals

We welcome the Board's Consultation Paper for the reasons set out by Mrs Justice Davies and quoted at paragraph 1.6 of the Paper.

We agree that there should be guidance which describes the purpose, parameters and critically the range of available sanctions. The range of sanctions available is wider than just fines, and fines may not always be the most effective or appropriate sanction. Appropriate sanctions guidance will help to bring transparency to the process, clarity for participants, proportionality, and consistency where consistency is warranted.

Sanctions should seek to prevent reoccurrence. The guidance should clarify the difference between a sanction which is imposed for misconduct by a member, and a sanction which is imposed for misconduct by a member firm. Misconduct by a member in itself does not warrant a sanction on a member firm. However, sanctions on a firm may be appropriate for certain types of misconduct, for example where the member firm should have taken action against an errant member but didn't.

Before addressing the questions posed in the Paper, we should like to make the following general points:

1 The use of the word "misconduct" to describe behaviour liable to disciplinary action tends to characterise (no doubt unintentionally) most such behaviour as something which it is not.

  Prior to the AADB Scheme, "bad work" was charged as "conduct falling below the standard reasonably to be expected of a member in good standing". Where "bad behaviour" was alleged, this was charged specifically as "misconduct".

  This important distinction was understood by the public for whom "misconduct" had a generally accepted meaning, and contrasted with complaints of "bad work".

2 The Board's Accountancy Scheme introduced a significant change in nomenclature. It now defines the word "misconduct" as being conduct "which falls short of the standards reasonably to be expected of a Member or Member Firm" (essentially the same as the previous "bad work" definition) so that "bad behaviour" and "bad work" now denote the same meaning. "Bad work" misconduct is not misconduct in the generally accepted meaning of that word.

   Whilst it is of course for the Scheme to use such language as the participants may agree, we consider it to be essential, when assessing penalties, that "bad work" misconduct and "bad behaviour" misconduct are considered separately.

3 In our view, for the proposed sanctions regime to be seen to be relevant, credible and in the public interest the investigation by the AADB and Tribunal decision needs to be carried out in a timely manner.

4 The proposal that member firms should be fined according to a proportion of their group turnover is not appropriate and would produce results that are unfair. Where a fine is considered appropriate in relation to a member, a starting point should be the fees generated from the audit being investigated. Where a fine is considered to be appropriate in relation to a member firm, a starting point should be a percentage of the fees generated by its audit practice.

Our responses to the specific questions follow in the appendix to this letter. If you have any question about this letter, please contact me.

Yours sincerely

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Appendix: Response to Specific Questions

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

Our sole objection is that Tribunals would be required to have regard to the Macrory principles: one of these principles aims "to restore the harm caused by the regulatory non-compliance…". This is not part of the AADB's remit, but a matter for the civil courts. We agree that the purpose of AADB sanctions is not to punish but to protect the public interest.

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?

Yes. If appropriate Guidelines can be formulated, we believe that they would be supported by all stakeholders. However, the current proposals are not appropriate. The framework needs to describe a range of sanctions, not just fines; needs to distinguish between sanctions for misconduct by a member, and when it is appropriate, levy sanctions against the member firm; sanctions should seek to prevent reoccurrence.

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?

Sanctions should encourage excellent work as the best way of protecting the public. They should distinguish between, to use the Cross Committee terminology, "bad work" and "bad behaviour". Sanctions for "bad work" should take account of the fees made from that work; whereas sanctions for "bad behaviour" are likely to require more drastic penalties such as exclusion from or suspension of membership. An additional financial penalty will seldom be appropriate in such circumstances. Sanctions should seek to prevent reoccurrence; distinguish between members and member firms.

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

Some of the factors have been included. A Tribunal should, however, begin by considering whether the "misconduct" is "bad work" misconduct or "bad behaviour" misconduct. It should also consider whether there are factors which have prevented the firm and members from co-operating as fully as they would have liked, such as the existence of a civil claim against them, or their involvement in criminal proceedings, particularly as witnesses. Some of the factors set out may be relevant in some cases but not in others – it should not, therefore, be mandatory for them to be taken into account. In arriving at an appropriate fine in relation to regulatory offences we support the principles described in the case R v Howe & Co (Engineers) Ltd [1999] as summarised and applied in the January 2012 tribunal decision

(paragraph 29) on PricewaterhouseCoopers LLP re: JP Morgan Securities Limited Client Money."

See the following link: http://www.frc.org.uk/FRC-Documents/AADB/Decision.aspx

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

See response 4 above.

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

If a fine is an appropriate sanction then the level of the fine should be appropriate to the specific case, and Guidance should assist Tribunals in reaching the correct figure. In some cases this will lead to the imposition of heavier fines than at present. We do not accept that there should be a general increase in all fines

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

We believe that the starting point should be the fees obtained from the piece of work being investigated. It will then be for the Tribunal to apply a multiplier to this figure, taking into account the factors in the Guidance including the amount of work of this type done by the firm.

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

If a fine on the firm is appropriate then of the three mechanisms proposed in Appendix A paragraphs 32 and 33 for determining fines, the most appropriate is that marked in green but, in place of the percentages proposed, ranges of sterling amounts should instead be used, based on fees from the audit practice, not the member firm's group turnover from all services.

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

See responses 7 & 8 above.

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?

No. These are proceedings which are more analogous to criminal than to civil proceedings. We believe that a criminal court would consider the total burden on a defendant before ordering costs. In disciplinary proceedings, where a losing respondent is almost always ordered to pay a sum towards the Executive Counsel's costs, this should be taken into

account in considering the total burden before imposing a fine.

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

a Most accountancy firms provide a wide range of services to public and private sector clients. In the largest firms (those most likely to become liable to AADB disciplinary action), scale means that partners in the non-audit business streams may have a lesser impact on the audit practice than the self-regulatory nature of smaller firms.

b Some firms have incorporated their audit practice separately. If those firms were to become the subject of disciplinary proceedings by the AADB in an audit matter, the member firm against which proceedings would be brought should be the registered audit entity. Any method of calculating a fine which looked at the revenues of any entity other than the registered audit entity would in our view be questionable and likely to be struck down by the courts. It would be wrong in principle to apply a different methodology to firms which have incorporated different parts of their business separately. The method used by some of the professional bodies (eg the ICAEW) to calculate fines uses as its base the fee for the work in question.

c We believe that the correct approach for misconduct by an individual is to look at the fees which have been made from understanding the audit in question.

d The proposition that larger fines must be imposed by the AADB to deter firms or individuals from committing misconduct is misconceived, in that it rests on the premiss that insufficient deterrents currently exist to the commission of misconduct. Large firms do not need the prospect of larger fines on the AADB's part to deter them from committing professional error as opposed to professional misconduct.

e The prospect of an adverse finding by the Tribunal is of itself a far more powerful deterrent than larger fines would offer.

f A finding by a Tribunal of misconduct against a member will either terminate or severely impair the career of the member involved. A finding of misconduct causes severe financial detriment to the professionals involved even without the imposition of a fine. The prospect of having one's career ended or one's reputation shredded is of itself a powerful deterrent.

g A starting point which considers the turnover of a member firm as a whole is likely to be unfair when considering misconduct by an individual who has acted for example in isolation or in contravention of a firm's procedures; probably unlawful; and to be disproportionate because it fails to target the source of the "bad work" whilst also punishing the innocent. In the view an act or series of acts that demonstrates a lack of integrity or dishonesty requires the removal of the ability to practice. Fines do not appear to be appropriate whether on the member or the member firm.

h The levels set out at para. 4.17 of the consultation paper should draw directly on the definition of misconduct as described in the AADB scheme rules. Levels 1 and 2 appear to describe work that was not negligent. In other words, they relate to work that meets the standard of skill and care that should reasonably be expected of the

professionals and firm in question. In such circumstances, no finding of misconduct could be supported.

i Of the three mechanisms for fines proposed in Appendix A paragraphs 32 and 33 for determining fines, the most appropriate is that marked in green but, in place of the percentages proposed, ranges of sterling amounts should instead be used. However, the range of sanctions described in the guidance should be broader than just fines, and distinguish between sanctions on the firm and sanctions on the individual. Sanctions on the individual could encompass options such as requirement for additional training, second partner reviews, requirement to obtain an independent review, withdrawal of ability to accept new clients for a period, withdrawal of practising certificate for a period.