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[redacted]

Sent by Email: AEPconsultation@frc.org.uk

Dear Sir or Madam

Consultation on proposed amendments to the Audit Enforcement Procedure

We welcome the opportunity to respond to the Financial Reporting Counsel ("FRC") Consultation dated 22 July 2021 (the "Consultation") on proposed amendments to the Audit Enforcement Procedure ("AEP").

We have set out in Appendix 1 our detailed responses to the proposed amendments. However, we wish to highlight the following:

- Page 5 of the Consultation states that the proposed amendments are intended to ensure a "*clearer and more effective and robust enforcement process*". We are of the view that many of the proposed amendments do promote clarity. However, we are concerned that some other proposed amendments appear focused on enforcement at speed, rather than on due process.

- It would be helpful if the FRC could set out how, its proposals, to amend the AEP are linked to the regulatory and investigations framework envisaged in the Government's recent White Paper on Restoring trust in audit and corporate governance. It would seem to us that any change must align with and support the changes that will be implemented by the Government. In the specific:

    - Is it intended that the AEP be further amended to apply to investigations involving non-accountant company directors alongside auditors, or will a separate regulatory framework be put in place?
    - Assuming this will be dealt with under the AEP, in terms of timing, it is not clear why the FRC is proposing to amend the AEP in advance of these anticipated, more wholesale changes. Therefore, it would be helpful to have clarity on whether or not additional consultation proposals - to introduce consequential changes to the AEP – will be published in due course.

- Finally, we note that no comparison table/text, between the existing and proposed procedure, is supplied with this Consultation. Whilst not a point that impacts this firm, we do think this could have implications on the accessibility of the Consultation to other interested parties. Comparison software is certainly widely, but may not be universally, available.

We look forward to continuing our dialogue with the FRC on the implementation of these recommendations, particularly within the context of the wider Government reforms, and would welcome the opportunity to discuss any elements of our response in more detail.

Yours faithfully

For and on behalf of Ernst & Young LLP

Encl. as above

Appendix 1 – Proposed Amendments

Part 1 – Interpretation/Glossary

Most of the amendments to Part 1 reflect amendments elsewhere in the AEP, or are minor or clarificatory. For example, the definition of "Statutory Auditor" has been amended to clarify that it applies to relevant persons who met the definition at the time of the conduct that is to be investigated.

We agree that many of the proposed amendments are consequential to the other amendments proposed. We do not object to the amended definitions, subject to our comments as set out below.

In particular, we note that under the new definition of "Costs", disbursements are now included in addition to costs and expenses. The FRC should provide a higher level of transparency in terms of FRC costs, expenses and now disbursements, including as to their reasonableness. In addition, on the question of transparency of costs, the FRC should show how ICAEW levies, which are paid by firms in part to cover the costs of enforcement, are taken into account in cost calculations. As noted in relation to Part 10 below, we consider that a power to order that the FRC's costs be assessed by an independent party in appropriate circumstances (current Rule 93(c), which has been removed from the new Rules) is very important and should be retained.

Part 2 – Initial Stages

Amended Rule 3 clarifies the powers available to the Case Examiner to determine if there is a question as to whether the Statutory Auditor or Statutory Audit Firm has breached a Relevant Requirement.

The amendments to Part 2 to the Case Examiner's powers appear to codify / clarify the process and powers already being utilised by the Case Examiner.

We consider that the proposed amendments are generally helpful. However, in relation to draft Rules 6-11 it would be helpful, and provide greater clarity, if "the matter" being considered by the Case Examiner was properly detailed / defined. This would enable the Respondent to provide relevant information to be considered by the Case Examiner prior to making a direction / referral.

Similarly, we invite the FRC to set out more detail / a definition as to what is meant by the "scope of the investigation" in the proposed Rule 11 (dealing with the contents of a Notice of Investigation where the Board refers a matter for investigation). This would also assist in facilitating early settlement discussions (as to which see our comments on Part 6 below).

We also consider it may assist the efficient resolution of matters (including by way of early settlement) if the AEP included an obligation to notify the Respondent in advance of a referral under Rules 5 and 11 and seek representations from the Respondent at this stage.

Part 3 – Investigation

New Rules 12 and 13 have been included to provide for the scope of an investigation to be amended where related breaches of Relevant Requirements are suspected, rather than for a new investigation to be opened. This will further facilitate the proper and thorough investigation of suspected breaches of Relevant Requirements.

Please can the FRC confirm what is meant by a "related breach" (which we note does not appear anywhere in the proposed new Rules)?

Assuming that the intention is to enable only clearly related issues and parties to be added to an existing investigation, it is important that the Rules should not be used inappropriately to expand the scope of an investigation into unrelated, or only tenuously related, areas or parties (which should properly be the subject of a new investigation process). As currently drafted, the new Rules give seemingly unlimited discretion to Executive Counsel/the Board, without any guidance as to how that discretion will be exercised in practice.

For clarity, certainty and fairness, we consider that the new Rules should set out clearly the circumstances and criteria by which the Board must consider and approve any request by Executive Counsel to amend the scope of the investigation under these Rules. We suggest that the Board should only accede to a request by Executive Counsel if it is satisfied that:

- The proposed amendments to scope arise out of substantially the same facts and circumstances of the original investigation; and/or
- The statutory audit(s) of the same entity (or its parent or subsidiary entities); and
- The amendments (including the addition of new Respondents) are necessary in the interests of justice, including the saving of time and costs, and the fair disposal of matter; and
- Will not cause injustice to any party,

and that the proposed new Rules should be amended to include such criteria.

Revised Rules 16-17 will facilitate prompt investigations by removing the previous requirement for Executive Counsel to prepare an Initial Investigation Report at the conclusion of an investigation. Executive Counsel will instead prepare an Investigation Report, and the Respondent will have the opportunity to make written representations on its contents. This will facilitate prompt conclusions of investigations by reducing the administrative burden on Executive Counsel.

We understand that the FRC is seeking to streamline the investigatory process and we remain fully supportive of the FRC's desire to have an efficient and timely enforcement procedure. It may be the revised Rules will contribute towards that aim.

Equally we can also see that it may have been helpful, in past cases, for the FRC to effectively test its interpretation of Relevant Requirements by way of one or more drafts of an Initial Investigation Report before moving to a final Investigation Report. Such process may have led to fewer cases being referred on to the Enforcement Committee and/or Tribunal, as agreement as to breaches of Relevant Requirements could be reached.

In our view, it is likely that the views expressed in the Initial investigation Report may be less fixed than those included in an Investigation Report. We also question whether this proposed change will, in fact, lead to any time saving, as it is likely that the time currently employed around preparation of the Initial Investigation Report and the attendant Representations stage will simply be subsumed into the Investigation Report and attendant Representations stage. The answer in either case may lie in the constructive nature of any dialogue between the parties, all of whom are committed to securing improvements in audit quality.

Under the current AEP, the Executive Counsel must provide any "*relevant accompanying papers*" with the IRR, whereas under the proposed amendments to Rule 16, the Investigation Report must "*disclose the key evidence that Executive Counsel considers relevant*". This substitutes an objective test of relevance with the subjective view of the Executive Counsel of what amounts to both "key" and "relevant" evidence and suggests an intention to reduce the evidence in support of Executive Counsel's case that is supplied to Respondents at this stage of proceedings.

Such an outcome would, in our view, be contrary to the interests of fairness (in the Respondent knowing and understanding the case it has to meet) and the joint objective of the timely recognition of failures, in and the improvement of, audit quality. In the interests of transparency and the timely and fair resolution of investigations in appropriate cases without the need for the delay and expense of a Tribunal process, we consider that proposed amendments should make clear that the Executive Counsel should disclose in full all factual and expert evidence supporting the conclusions in any report at the stage of delivery of the Investigation Report (including interview transcripts from any other relevant interviewees including Responsible Individuals with separate representation and third parties).

New Rules 19-20 make explicit Executive Counsel's discretion to pursue Enforcement Action against a Respondent when Executive Counsel has found that the Respondent breached a Relevant Requirement.

We welcome this proposed amendment and its explicit recognition that not every breach of a Relevant Requirement (a lower test than under the Accountancy Scheme) should be the subject of enforcement action.

New Rules 23-28 provide that, following a decision by Executive Counsel to pursue Enforcement Action, that an independent person ("Independent Reviewer") must approve the issue of a Final Decision Notice after a Proposed Decision Notice has been agreed by the parties. These amendments will ensure that sanctions imposed will be proportionate and fair. Where the Independent Reviewer does not approve the issue of a Final Decision Notice, Executive Counsel may either issue a revised Proposed Decision Notice or refer the matter to the Tribunal.

We do not consider that the suggested abolition of the Enforcement Committee and the introduction of a new Independent Reviewer necessarily represents an improvement to the existing process. We understand that the intention is that a sole Independent Reviewer will be appointed by the Convener from the lawyers who sit on the Tribunal Panel. The review will be independent in the sense that the Independent Reviewer is not, and will not, be involved at any other stage of the case, but we are concerned that a single lawyer selected from the Tribunal Panel cannot provide an appropriate safeguard/check on the powers of the Executive Counsel.

In addition, there is no detail in the proposals about what information an Independent Reviewer will be provided with in order to inform their decision, or how it is anticipated that they will familiarise themselves with the facts and issues (particularly in complex cases). We would welcome guidance on this point.

The suggestion that one reason for the change is because in all cases to date Respondents have agreed with the Proposed Decision Notice issued by Executive Counsel, such that there have been no referrals to the Enforcement Committee under the current AEP, seems to us to overlook the possibility that the availability of a review by such a committee has focussed minds on both sides and enabled the agreement of Decision Notices. We therefore consider that there is value in retaining the ability to make a referral to the Enforcement Committee, where there is disagreement concerning the Proposed Decision Notice on the basis that the Enforcement Committee comprises three members of the Enforcement Committee Panel with differing expertise and knowledge.

The existing referral process incorporates a number of important safeguards in the current Part 4 of the AEP, which have been omitted from the new Independent Reviewer process. These allowed the Enforcement Committee to provide the Respondent with copies of any document that may be considered relevant that had not previously been provided to the Respondent; to invite the Respondent to provide written representations and further documentation on the Allegation and/or Executive Counsel's recommendation for Sanction; and to adjourn for further enquiries of the Parties to be conducted as it considered necessary and invite Executive Counsel and the Respondent to attend to make oral submissions.

We suggest that such safeguards properly form the part of any fair and meaningful review process, whether performed by the Enforcement Committee or otherwise. The omission of the express requirement for the Independent Reviewer to provide the Respondent with additional relevant documents not previously provided by Executive Counsel gains particular prominence given proposed amended Rule 16 upon which we have commented above.

We are also concerned that the proposal contemplates that the sole Independent Reviewer could seek to override the terms of any Proposed Decision Notice already agreed by the Executive Committee and the Respondent. We consider that it is potentially onerous and unfair if an Independent Reviewer is able to override such agreement (particularly in view of the expanded definition of "Costs" and the new Rule 142 (as to which please refer to our comments below). It is unclear to us how this step, in itself, can be said to ensure that any sanctions imposed are proportionate and fair.

New Rules 30-31 provide Executive Counsel with a new power to refer a case directly to the Tribunal. This reflects the proposed abolition of the Enforcement Committee stage.

Please see our comments above concerning the proposed abolition of the Enforcement Committee stage.

Part 4 – The Tribunal

New Rule 34 clarifies the requirement for Executive Counsel to serve a document at the beginning of the Tribunal stage of proceedings which sets out the particulars of the case against the Respondent, along with any supporting factual evidence.

The proposed amendments are silent on when the Executive Counsel will provide supporting expert evidence. As set out above in our response concerning the revised Rules 16 and 17, in the interests of transparency and the timely and fair resolution of investigations in appropriate cases, we consider that any supporting expert and factual evidence should be provided prior to the Tribunal stage as early as possible in the process (in order to support the Executive Counsel's report on her findings following her investigation).

New Rule 52 has been introduced to permit the Tribunal to treat a finding or court-approved statement of fact made by other bodies or officers as prima facie evidence of that fact in the Tribunal's proceedings, allowing for the efficient disposal of issues.

We disagree with this amendment, as currently drafted, on the basis that the bodies and officers potentially covered by Rules 52 (d) and (e) appears to us to be unduly wide. We consider that the current drafting goes far wider than the equivalent concept in litigation of "res judicata", which is limited to decisions by judicial tribunals with appropriate jurisdiction and which we consider would be a sensible approach for the FRC to adopt.

There is a danger of reports of a wider range of bodies or officers being adduced as prima facie evidence not only of the overall determination by such persons, but also of the truth of the 'facts' stated in their reports, even where those facts may be heavily disputed by a Respondent (either in whole or in part), including in circumstances in which the Respondent has not taken part in the relevant process or proceedings or been able meaningfully to challenge the relevant 'facts; and / or where the Respondent disputes the competence of the body or jurisdiction. In addition, there is a danger of the Tribunal "*cherry-picking*" facts / findings without taking context into account. The burden will then be on the Respondent to seek to 'disprove' the relevant facts, which will be onerous, time consuming and potentially costly, and risks significant unfairness to Respondents.

In addition, proposed Rule 52(e) gives very wide discretion to a Tribunal to recognise, and accept findings of 'fact' in, other 'non-legal' reports or proceedings, including those whose fairness or safeguards around due process may reasonably be subject to challenge. For example, does the FRC consider that this proposed new Rule can and should allow a Tribunal to recognise, and accept as true, 'facts' found as part of an investigation and report by a parliamentary select committee (or equivalent procedure in another jurisdiction), i.e. an essentially political process? This outcome would be wholly inappropriate.
At the very least, if provisions such as those in proposed Rule 52(d) and (e) are to be included in the amended AEP, the new Rules must provide for adequate and early disclosure by Executive Counsel that he/she intends to rely on findings of fact from the relevant body/officer/report, together with disclosure of the relevant facts themselves, and the judgment, report or other findings of which they form a part. This disclosure should be made to Respondents with the other evidence provided to accompany the Initial Investigation Report/Investigation Report, so that the Respondent may know the case they have to meet and make relevant representations, prior to any decision that they should become liable for Enforcement Action.

Revised Rule 73 has been amended to make express provision for closing submissions at the end of a Tribunal hearing.

We welcome this proposed amendment.

New Rules 75-78 provide that a Tribunal shall issue separate Final Decision Notices in respect of liability and sanction, removing an impediment to the transparency of earlier publication of liability findings.

Whilst we welcome efforts to make Final Decision Notices more transparent, in view of the focus on streamlining the AEP it is important that the FRC provide information on what impact this proposed amendment might have on: (i) timing; and (ii) costs of the AEP (particularly given the expanded definition of "Costs" and the new Rule 142 as to which please refer to our comments below).

We also note that in conjunction with revised Rule 162 and the revised definition of "Final Decision Notice" to remove the reference to sanctions, the proposals would give the FRC the power to publish a Final Decision Notice as to liability in advance of any sanctions hearing. We consider that in the interests of observing due process and procedural fairness, any Final Decision Notice as to liability should be delayed until the Final Decision Notice in respect of sanctions is published.

Part 5 – Interim Orders
These amendments clarify and detail the procedure to be adopted for Interim Order proceedings. The Rules address the grounds for making an Interim Order, the timing of any hearings (whether ex parte or on notice) and the basis of any challenge by a Respondent to an Order.

We consider that, on the whole, these amendments are helpful in clarifying the procedure. However, we consider that in the interests of fairness, the "risk of unfair prejudice and injustice to the Respondent" should be added to the list of non-exhaustive factors in Rule 85(b) that the Tribunal will take into account in determining whether an Interim Order Hearing is appropriate.

Part 6 – Settlement
This new Part provides an express power for Executive Counsel to agree a settlement agreement (i.e. conclude enforcement proceedings by agreeing a sanction or sanctions) with a Respondent. Any such agreement will be subject to oversight by an independent person, the Independent Reviewer, before it is approved. This new power will ensure that appropriate and proportionate case management decisions can

be taken that reflect the dynamic nature of enforcement proceedings. Executive Counsel will retain the ability to continue to pursue Enforcement Action where settlement discussions do not prove fruitful.

On the whole we consider that the amendments are helpful. However please see our comments above concerning the requirement for the Independent Reviewer to approve a Proposed Decision Notice agreed between the parties, which apply equally to the proposal that the Independent Reviewer be required to approve any settlement agreement. In addition, the FRC should consider whether more can be done to encourage settlement at an earlier stage in appropriate cases.

Part 7 – Appeal

Rule 112 has been amended to provide Executive Counsel with the same rights of appeal as a Respondent. Rule 113 has been amended to provide that the time period for appealing a Tribunal's decision on liability is extended to 28 days after the issuing of a Final Decision Notice in respect of sanctions imposed. Rule 117 has been amended to rationalise the available grounds of appeal for appeals to the Appeal Tribunal. Other amendments in this Part are minor, clarificatory or consequential only.

The proposed amendments do not address the key issue with the appeals process, which is that a right of appeal to a truly independent body outside of the regulatory regime (i.e. the Courts) should be available to Respondents. The FRC should build into the AEP a right of appeal for Respondents to the High Court (similar to that which exists for decisions made under the Solicitor's Regulation Authority Rules).

Part 8 – Reconsideration

Other amendments in this Part are minor, clarificatory or consequential only.

We do not agree that all of these amendments are "*minor, clarificatory or consequential only*". We note that whilst under the current AEP the Board is able to reconsider any decision made under the Rules set out in the AEP (in some cases only with consent from the Respondent), under the new proposals the Board is only able to reconsider decisions made under Rules 5(a) (Case Examiner's decision to take no further action), 5(b) (Case Examiner's decision to arrange Constructive Engagement, 6 (Board's decision to direct the Case Examiner to attempt to resolve the matter through Constructive Engagement) and 10 (Board's decision not to investigate a matter and take no further action).

We also note the proposal to reduce the threshold for reconsidering decisions in the absence of new evidence (from (i) decision was wrong in law, unfair because of a serious procedural irregularity and / or irrational, i.e. a similar standard to the test for judicial review, to (ii) decision was "materially flawed, for any reason, in whole or in part"). It is in the interests of both parties that decisions made under the AEP are certain and binding and we consider that the new standard is open to a high degree of interpretation.

We do not support these changes to the current AEP.

Parts 9-11 – Sanctions, Costs and General

Where a Notice of Closure is issued to a Respondent, revised Rules 148 and 149 remove the requirement to notify, and provide reasons to, any co-Respondents and introduce a new requirement to provide the Notice of Closure to the affected Respondent's supervisory body. In respect of Notices of Closure issued pursuant to Rule 146, it is inappropriate to notify Respondents of matters relating to co-Respondents. In respect of Notices of Closure issued pursuant to Rules 147, Respondents will be aware of the status of proceedings in respect of their co-Respondents and formal notification requirements are unnecessary.

In order to answer the case against them, Respondents should be updated where a Notice of Closure is issued to other Respondents, given that this could be relevant to the Allegations against them. In addition, under the current AEP the Executive Counsel retains discretion as to whether they notify other parties (the

current AEP states that the Executive Counsel should "*inform any other Party as appropriate*") so we do not consider that this amendment is necessary.

Revised Rule 136(d) removes the upper limit of a temporary prohibition on a Respondent from carrying out Statutory Audits or signing an audit report, which was previously set at three years. The powers to impose conditions under Rule 96(k) and to accept undertakings under Rule 97 of the current version of the AEP have been removed.

We do not object to these proposed amendments.

New Rule 142 clarifies that a Tribunal may award costs in respect of the Tribunal's administrative expenses. This will ensure that the Tribunal can recoup the costs of its expenses in holding hearings.

Taken in conjunction with our comments above concerning (i) the new requirement for separate hearings on sanctions and costs, (ii) the proposed role of the Independent Reviewer, (iii) the expanded definition of "Costs" and (iv) the removal of the ability under the current Rule 93(c) for the Chair to order that costs be assessed by an "appropriate person", such amendments are likely to significantly increase the Respondent's potential financial exposure, and make it all the more important that there is greater transparency on costs and their reasonableness. We assume that the FRC would not expect to recover its Tribunal costs incurred in relation to issues which are subsequently dropped during the course of the Tribunal hearing but would be grateful for express clarification on this point.

In this context, we consider that an explicit power for the Tribunal to order that the FRC's costs be assessed by an "appropriate person", which should include an independent party such as a legal costs consultant, is important and should be retained (current Rule 93(c)). It is consistent with, and will help give effect to, the requirement in regulation 5(5) of SATCAR which provides for the recovery only of costs "reasonably incurred" by the FRC.

New Rules 153 to 160 make provision for Joint Tribunals. Joint Tribunals will be capable of dealing with cases that arise under the AEP as underpinned by the statutory framework for statutory audit regulation and other non-statutory disciplinary schemes operated by the FRC by arrangement with the accountancy and actuarial professional membership bodies (the Accountancy Scheme and the Actuarial Scheme). This change is designed to enable one Tribunal to hear cases arising from the same factual circumstances that engage those different FRC procedures. There is a different standard under the Schemes (Misconduct) for a Respondent to be liable to sanction than under the AEP (breach of a Relevant Requirement), and Joint Tribunals shall apply these different standards as appropriate.

Given this significantly increases the scope for hearings by a Joint Tribunal, we would appreciate more detail on how the proposed amendment is expected to work in practice, e.g. in what situations would it be appropriate for a Formal Complaint under the Accountancy Scheme and a Formal Complaint under the Actuarial Scheme to be heard jointly?

New Rules 165-166 make express provision in respect of the confidentiality safeguarded by s1224A Companies Act of non-public information gathered by the FRC under the AEP.

We do not object to these proposed amendments.

New Rules 169-170 set out the provisions necessary to set out when the amended AEP will come into force, and how it will apply to ongoing and new matters. The amended provisions seek to ensure that "live" matters can proceed under the new AEP, without prejudice to Respondents.

We do not object to these proposed amendments.