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For the attention of Anna Colban
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19 September 2012

Dear Sirs

Consultation Paper – Disciplinary Schemes Proposed Changes

We appreciate the opportunity to comment on this consultation paper from the Financial Reporting Council (FRC). Since the consultation was published, responsibility for operating the disciplinary schemes is in the process of transferring from the Accountancy and Actuarial Discipline Board (AADB) to the Conduct Committee under the new FRC structure.

We have considered all seven questions in the consultation paper and our specific views on these are included in the Annex to this letter. In this covering letter we provide some overall observations on what we believe to be the more important issues raised by this consultation document as highlighted below.

Enhancing the efficiency of the disciplinary schemes

As stated in our recent responses to the consultations on the FRC Reforms and the Sanctions Guidance for Tribunals, we support changes that will enhance the efficiency of the conduct and disciplinary processes. We believe that many of the changes proposed in the consultation paper will be helpful in that regard.

That said, we note that there have been several sets of amendments to the AADB Scheme since its inception. We suggest that a helpful outcome from the current consultation would be a period of stability that ensures that rule changes are not as frequent in the future as they have been in the past.

Roles and responsibilities of the Conduct Committee

As noted above, following implementation of the FRC's Reform proposals, responsibility for operating the disciplinary schemes is transferring to the new Conduct Committee (CC). According to the material published with the Reforms, the CC will set strategic goals for the FRC's supervisory, monitoring and disciplinary work.

Although the CC is at an early stage of its work, there is a risk that it could be perceived to have overlapping and potentially conflicting responsibilities and objectives. According to the FRC's Draft Plan and Budget for 2012/13, the major activities in relation to Conduct for the coming year include:

- *'Responding to matters drawn to the FRC's attention as a result of complaints or public comment, and encouraging referrals……*
- *Monitoring and reporting on the quality of audits….*
- *Overseeing the regulatory processes of the RSBs…..in respect of auditing.*
- *Overseeing the regulatory activities of the accountancy and actuarial professional bodies.*
- *Making significant progress on, and where possible finalising, the disciplinary cases with which the AADB is currently dealing. Identifying and investigating other matters which meet the criteria for investigations.*
- *Reviewing the disciplinary scheme and developing sanctioning guidance for its tribunals'.*

These differing activities require the FRC to maintain relationships with, and to treat fairly and be accountable to, a range of stakeholders – and to manage potentially conflicting roles. For example, as noted in our response to Question 1, we would be concerned if supervisory inquiries initiated in pursuit of the FRC's various regulatory objectives were to trigger automatically a series of associated disciplinary processes.

As noted in our response to the FRC's Reform proposals, we believe that, as a body acting in the public interest, the FRC should be seen to be setting an example of good governance in its own arrangements. This would include ensuring appropriate safeguards to manage differing and overlapping public interest objectives, and reviewing periodically the effectiveness of its operations. We note from the Impact Assessment of the FRC Reforms that, as part of the planned post-implementation review, there will be a full evaluation of the effectiveness of the proposals after three years. We suggest an evaluation of the governance arrangements of the CC as part of that review, to assess how the committee is managing its different activities and responsibilities to stakeholders.

Involvement of the Professional Bodies

The proposals seek to reduce the involvement and agreement of the relevant professional bodies. The reasons for this are that the Conduct Committee wishes to enhance the perception of its independence as well as to reduce delay in the relevant procedures.

While we are not opposed to some of the proposals to reduce the involvement of the relevant professional bodies (for example in requiring their agreement to minor changes in the scope of an investigation), we are concerned that there should continue to be sufficient consultation with those bodies as we believe this is important to the quality of the decision-making. Given the significant consequences of the Conduct Committee's decisions, especially in relation to disciplinary matters, it is important that the decisions made are fair and robust. The considerable experience which the

professional bodies have, including with regard to what may be expected of Members and Member Firms in relation to the audit process, is not something that should be lost. Furthermore, those who conduct the investigative function within the ICAEW are separate from other parts of that body. This helps to underpin the objectivity of those at the ICAEW looking into matters of conduct.

Investigative activities and defining 'misconduct'

While we support many of the proposals in the consultation paper, we are concerned about the 'misconduct' part of the investigation test. We believe the definition of 'misconduct' covers too broad a range of behaviour. The definition in the current scheme suffers from the same difficulty. Allied to this, following on from our comments above regarding the Conduct Committee's different responsibilities, we believe there should be greater clarity regarding the types of behaviour that might be examined as part of the FRC's routine monitoring and regulatory activities, and those that properly warrant investigation under the disciplinary processes.

Misconduct is defined in the Scheme as *"conduct ...which falls short of the standards reasonably to be expected of a Member or Member Firm"*. Cases where the auditor's performance falls below the standard normally expected could result from, for example, a relatively inconsequential failure to apply a specific step in audit standards.

We suggest in our response to Question 6 that the definition of what constitutes 'misconduct' should be reworked so that it is clear what type of cases should fall under the FRC's Schemes. It should in our view apply only to the more serious cases of behaviour where the profession is brought into disrepute – it is these cases where there is a demonstrable public interest and which should properly be examined under the AADB or its successor disciplinary arrangements. As we understand it, the FRC is not seeking to embrace cases of carelessness, but something more serious. An amendment of the wording would therefore seem appropriate for the avoidance of any doubt on the part of the public and the profession.

We would be pleased to discuss our views further with you. If you have any questions in the meantime regarding this letter, please contact Owen Jonathan (0207 804 3199), Pauline Wallace (0207 804 1293), Philip Mills (0207 213 2561) or Graham Gilmour (0207 804 2297).

Yours faithfully

PricewaterhouseCoopers LLP

ANNEX

PwC detailed responses to the questions in the Consultation Paper

1. Should the Schemes be amended as set out in paragraphs 3.3-3.11 so as to enhance the independence of the disciplinary arrangements?

We agree that independence, both actual and perceived, of the disciplinary arrangements is an essential element in maintaining confidence in the arrangements. That said, we also believe that consultation with the professional bodies is important in contributing to better-informed decisions. This is reflected in some of our detailed comments below.

Paragraph 3.2: While we understand the objective of ensuring independence from the profession, we believe there is an appropriate balance to be struck between, on the one hand, pursuing complete independence from the profession and, on the other, ensuring that this does not result in unintended consequences. In particular, if the requirement for the professional bodies' agreement is no longer to be required in respect of future Scheme changes, this could lead to a situation where the regulator is perceived to be changing the rules in circumstances where there is reduced accountability for it to the profession. In our view, the risk of changes to the rules being made which are (or are seen to be) unfair will be increased if the safeguard of agreement of the professional bodies is no longer required.

Paragraph 3.3: We believe the requirement for the FRC to consult with the relevant professional body at the time of proposing to launch an investigation on its own initiative pursuant to paragraph 5(8) should remain. In the context of the Conduct Committee's consideration of what may or may not be reasonable conduct for an audit professional, the views of the professional body concerned will be of relevance and should in our view be sought. In particular, bearing in mind their wide experience, the professional bodies can provide vital insight, including into what may or may not be expected of a Member Firm or Member. We believe the continuing involvement of the relevant professional bodies in the process will help to ensure that the Conduct Committee's decision-making remains as robust, fair and well-informed as possible. This is especially important in view of the profound effects of the Conduct Committee's decisions upon Members and Member Firms.

Paragraphs 3.4-3.5: The consultation paper explains at 3.4 that the requirement to consult can add up to three months to the process of starting an investigation. Following what we say above, if the delays result in better quality decisions, then this would more than off-set the extra time involved.

Paragraph 3.6: We support the power to conduct preliminary enquiries, a power which already exists under the Accountancy Scheme. We note that this power can currently only be exercised in accordance with a protocol agreed with the professional bodies and that no such protocol has yet been agreed. We believe that such a protocol should be explored as a first step. Given their expertise in matters relating to accounting and auditing, there is an advantage in the professional body working with the FRC at the early stage of an investigation in order to ensure that the best decisions in terms of both the public and the profession are made.

Paragraph 3.8: The consultation document seems to underscore the potential for a matter to move from a supervisory to a disciplinary process. As noted in our covering letter, we are concerned about the potentially conflicting regulatory and disciplinary activities and objectives under the Conduct Committee. Supervisory inquiries initiated as a result of the FRC's various regulatory activities should not inevitably trigger a series of associated disciplinary processes. We suggest that the concentration of roles under the CC is something that might be looked at when the effectiveness of the new structures is assessed as part of the post-implementation review of the FRC's Reforms in due course.

Paragraph 3.9: We support removal of the requirement to consult the professional bodies where an investigation's scope is amended or refined in circumstances where there are only minor changes to the investigation. However if there were to be a significant change in the scope of the investigation (for example the addition of an entirely different party or expanding the scope to include an entirely different type of work), then the need to consult with the professional body to ensure the quality and fairness of the decision-making should be retained.

Paragraph 3.10: There has been a series of amendments to the AADB Scheme since its inception. We would welcome, as one of the outputs from this consultation, a process that stabilises the rule changes and ensures that they are not too frequent in the future. The experience of recent years is that members and firms have a limited time to become familiar with working with the latest rules before they are changed again.

2. Are the proposals to conclude cases without the need for a tribunal hearing appropriate (paragraphs 3.12-3.13)?

We support (as we indicated in our response to the recent consultation on Sanctions Guidance) the notion of resolving cases at an earlier stage without the need for tribunal hearings. Unnecessary costs have fallen upon firms in the past in relation to the need to hold formal tribunals even where matters have been agreed as between Members or Member Firms and the AADB. Hence we support the proposals at paragraph 3.12–3.13, subject to the following relatively minor suggested amendment.

The one proposed change in this area which we do not support is the suggestion that the "Settlement Approvers" should need to approve a settlement unanimously. Where there are more than two Settlement Approvers, then the matter should be decided by simple majority (as is the case with tribunal members at any eventual tribunal). The risk otherwise is that there may be one individual who could have (or may at least be perceived to have) too much influence over a case and the ability to settle it. This could lead to significant extra costs, time and stress for Members and Member Firm personnel concerned, in circumstances where this may be unnecessary.

3. Do you agree with the role envisaged for the Case Management Committee (paragraph 3.15)?

Yes. We note that the role of the Case Management Committee as described in paragraph 3.15 is essentially one of challenge to the decisions of the Executive Counsel and is therefore consultative rather than executive in nature. We support its role to this extent.

4. Are the proposals to facilitate the timely completion of investigations and disciplinary proceedings appropriate (paragraphs 3.16-3.18)?

In principle, we support these proposals. However, we believe the suggested time limit of eight weeks for a response to a draft complaint or set of draft complaints will be insufficient where there are multiple complaints to which to respond. There is provision for the FRC to allow for a longer period if they believe more time is required. Eight weeks may be sufficient in the case of a single complaint, but in the case of multiple complaints we believe a period of at least 12 weeks should apply.

5. Should the Executive Counsel be able to seek an interim order against a member or member firm? If so, are the proposed provisions (paragraph 3.19) appropriate?

We do not support this proposal.

There are already powers in place for the relevant professional bodies to intervene where necessary to prevent the continuation of any inappropriate behaviour on the part of a Member or Member Firm. No examples are provided of instances where the lack of availability of an interim order has in the past resulted in any adverse consequences for either the public or the profession. Accordingly, it is not clear to us why there is a need for such interim orders and, in the absence of clearer explanation with some examples as to the circumstances in which they should be used , we are unable to support the proposal.

6. Do you have any comments on the proposals to amend the investigation test (paragraphs 3.24-3.29)?

While the suggested amendments offer some improvement on the current Schemes, they do not address what in our view is the principal difficulty with the test - the definition of “misconduct”. The scope of cases regarded as constituting misconduct and hence falling under the FRC’s disciplinary regime is cast too wide, covering everything from carelessness to the most egregious behaviour, such as fraud or deliberate wrong-doing.

Under the current rules, Misconduct applies to conduct *"which falls short of the standards reasonably to be expected of a Member or Member firm"* (Scheme Rules 2(1)), which is essentially a negligence standard. The new proposed definition retains this same key phrase. We do not believe that either Member Firms or individual Members should be pursued for Misconduct merely for falling short of this standard. Individual Members (and especially audit engagement team members beneath the level of audit partner) should in our view be pursued for Misconduct only when their conduct could be considered egregious and such as to bring themselves and/or the profession into disrepute.

We suggest that the general understanding of a reasonably informed person is that "misconduct" indicates conduct that is considerably worse than negligence. The Oxford English Dictionary defines misconduct as *“unacceptable or improper behaviour”*. We have also looked at relevant definitions in legal dictionaries that would support our view.

The range of conduct covered by the definition to be adopted by the scheme is important because when the regulator publicises and the media (re)publishes the fact that a Member or Member Firm is being investigated for, has had a complaint made against them of or has been found liable for “Misconduct”,

the public is led to believe that the acts or omissions concerned are far more serious than may often be the case. This could do both the profession and the public a disservice, and could unnecessarily undermine confidence in the UK's corporate reporting environment.

Although the consultation does not specifically seek comment on this point, we believe the definition of misconduct should be redrafted to cover acts or omissions which constitute seriously deficient behaviour which could be regarded as improper or which bring the profession, the firm or the individual concerned into discredit or disrepute.

7. Do you have any other comments on the proposed Schemes or the points raised in this paper?

Appointment of Tribunal Panel

Insufficient explanation has been provided in paragraph 3.23 as to the rationale for transferring responsibility for the maintenance of the Tribunal Panel from the independent Convener, as currently, to the Conduct Committee.

If the Panel is to be maintained by the Conduct Committee, there is a risk that the perception of the independence of the Tribunal Panel may be impaired. It would be preferable if panel members do not consider themselves (or are not perceived to be) accountable to the Conduct Committee which appoints them, so that decisions they make are unquestionably independent and not what they judge to be the regulator's preference. We note in our covering letter the potential risks of combining regulatory and disciplinary roles in the same body under the recent restructuring of the FRC.

Responsibility of Successor Member Firms

We support the suggestion that a Successor Member Firm should be responsible for doing what it reasonably can to ensure that a Member Firm to which it is a successor and any Member who works for the successor firm appropriately cooperates with an investigation (Proposed Rule 12(1)). We do not see any case in making a Successor Member Firm responsible in a disciplinary sense beyond that. Indeed it would be perverse to hold a Successor Member Firm liable for Misconduct (and for the payment of any associated financial sanction) of the previous firm in circumstances where that firm could not be held legally liable for those acts or omissions, in the context of civil litigation. (Proposed Rules 4(7) and 11 (1)(ii)(c) need to be altered accordingly).

We believe the default period (for responding to requests for information and documentation) set out in proposed rule 12(2)(iii) of 14 days to be too short. This should in our view be 28 days.

Responsibility for acts/omissions of employees

We do not believe that acts or omissions of employees should be automatically attributed to a Member Firm. Each case should be assessed on its merits and we therefore do not support the proposed rule 4(10).

Settlement discussions and costs

There should be a clear statement in the rules that anything discussed in unsuccessful settlement discussions remains confidential.

The only exception to this principle should be in relation to the question of costs where an offer of settlement has been made. The costs regime should allow a Firm or Member Firm that may have made a 'without prejudice' offer to settle, at their sole discretion, to bring that offer to the attention of the Disciplinary Tribunal when considering the question of costs. This will be particularly relevant in circumstances where the Tribunal makes an award which does "not beat" what was contained in the settlement offer. This would be akin in part to the principles included in civil litigation cases under Part 36 of the Civil Procedure Rules.

Disclosure of information

We believe the wording of proposed rule 17(2) is too wide and should only refer to information "received in confidence from the FRC/Conduct Committee in the context of" a preliminary enquiry, an investigation or disciplinary proceedings. This should not extend, for example, to information which the Member or Member Firm might learn from a third party (not the FRC/Conduct Committee) during the period between when any preliminary enquiries commence and any disciplinary proceedings are completed (which could be a period of years).

Information received or learnt by a Member or Member Firm, other than via the FRC/Conduct Committee, may well be subject to separate confidentiality obligations owed to other parties. Those obligations will continue to apply in the normal way. However, no additional obligations to the FRC/Conduct Committee should arise in such circumstances, just because a preliminary enquiry, an investigation or disciplinary proceedings exist to which that information may be relevant.

Again, the reference to "information" in Rule 17(3) is too general and unspecific and could lead to confusion. We suggest the same amendment here as for proposed rule 17 (2) above.

European developments

We note that the European Commission published in November 2011 legislative proposals which may impact on the way auditors are regulated throughout the European Union (EU). The FRC should consider the relative merits of pressing ahead with further changes in the UK's disciplinary regime, in light of the fact that the Schemes have been altered on a number of occasions and those previous changes need to bed down, and the possibility of having to make further changes in a relatively short timeframe in order to accommodate requirements issued by the EU.