

June 2013

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# Auditor Regulatory Sanctions Procedure: Sanctions Guidance

## Consultation Document

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# **Auditor Regulatory Sanctions Procedure: Sanctions Guidance**

**Draft Consultation Document**

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## 1. Introduction

The Financial Reporting Council (“FRC”) is responsible for the independent monitoring of the performance by members of Recognised Supervisory Bodies (“RSBs”) of statutory audit functions in respect of major audits i.e. listed companies and other major bodies. This function is performed by the FRC’s Audit Quality Review (“AQR”) and through agreed arrangements with the RSBs pursuant to the Companies Act 2006 (“the Act”) which provides that RSBs must participate in such arrangements in order to maintain their recognition under the Act.

Amendments to the Act which took effect on 2 July 2012 included an additional requirement that the RSBs should also participate in arrangements for enabling the body performing the independent monitoring function to determine sanctions against members of the RSB where they have failed to comply with the Regulatory Framework for Auditing. Pursuant to this, the FRC consulted on a draft Auditor Regulatory Sanction Procedure (“the Procedure”) which has now been finalised following feedback.

In accordance with the Procedure, the Conduct Committee has the power to provide the Monitoring Committee, the Convener and any Independent Sanctions Tribunal with guidance concerning the exercise of their duties under the Procedure, who are required to have regard to any such guidance issued.

Sanctions are an area where it is considered appropriate and, indeed necessary, for the Conduct Committee to give guidance to Committees and Tribunals. The purpose of the guidance is to ensure transparency and consistency in the determination of regulatory Sanctions.

This was reinforced by the responses to the consultation on the Procedure, which called for Sanctions Guidance for the Committees and Tribunals. This was a dominant theme in the responses, and the FRC considered the proposals contained in those response in developing this consultation document.

It will be noted that the proposed Sanctions Guidance is principles based, rather than tariff based. This is considered appropriate and is consistent with the principles of good regulation, as is further set out in section 2.

The consultation period in respect of the Sanctions Guidance closes on 10 July 2013. It is envisaged that the Procedure will take effect from 1 July 2013, with the Guidance coming into force shortly thereafter, and that in practice it will apply to all AQR inspection activity commencing within its 2013/14 cycle.

## 2. Sanctions Policy

The FRC is committed to upholding the five principles of good regulation proposed by Sir Philip Hampton in his 2005 report, *Reducing Administrative Burdens: Effective Inspection and Enforcement*: proportionality, accountability, consistency, transparency and targeting. Sanctions Guidance should be consistent with these regulatory principles and with the overarching principles of fairness and natural justice.

These principles were incorporated into a mandatory code of practice in 2008, the *Regulators Compliance Code*. Although the FRC is not bound by the Code, the latter emphasises the need for all regulators to adopt a positive and proactive approach to compliance by responding proportionately to regulatory breaches. Amongst other matters, the Code prescribes that regulators should be transparent in the way in which they apply and determine penalties.

Further to the Hampton report, the Macrory report was commissioned by the government and *Regulatory justice: making sanctions effective* was published in 2006. This report emphasised the need for transparency in relation to the enforcement policy of regulators, and set out that such a policy should, inter alia, explain the range of enforcements options available to the regulator and explain the criteria upon which decisions are made when choosing what specific enforcement action to take in each case of non-compliance, including any aggravating or mitigating factors the regulator might take into account before applying a particular sanction.

The report sets out the characteristics of a good enforcement policy stating:

- ‘Enforcement policies must always retain a degree of flexibility, since I believe the choice of sanctioning response can never be a purely mechanical exercise. But if they are to be of real value to the regulated community, it is important that they are drafted with reference to the specific area of regulation to which they relate, rather than expressed in over-generalised terms, although I expect there would be some over-arching principles which would apply to all areas. (Para 5.11)
- The language in an enforcement policy should not however be over-specific on what a business should expect when found in each and every potential type of breach. This would be arduous and bureaucratic and would bind a regulator’s discretion too tightly leading to an overly rigid enforcement system that would not be beneficial for the regulator, the regulated community, or the public. Flexibility remains a cornerstone of a good enforcement system.’ (Para 5.12)

The FRC’s policy objectives in issuing Sanctions Guidance are to promote transparency, clarity, accessibility, predictability and a consistent approach by Committees and Tribunals to determining Sanction, with a view to securing proportionate Sanctions that will have an appropriate and credible deterrent effect and will bolster public and market confidence in the performance of Statutory Audit Functions by Registered Auditors.

The FRC considers that, in determining the appropriate Sanction, Committees and Tribunals should have clear guidance as to the approach that they should take. However, the guidance should be flexible and allow for the exercise of discretion by the Committee or Tribunal in taking into account the individual circumstances of each of a wide range of cases.

Therefore, it is considered appropriate that a principles based approach rather than a tariff based approach is more likely to provide the flexibility required under the new Procedure, bearing in mind the rationale for the change in the arrangements for determining regulatory Sanctions was to ensure independence. This is also consistent with the principles of good regulation, and with the Sanctions Guidance under the Accountancy Scheme issued by the FRC.

The Committee intend to keep the Sanctions Guidance under review and revise it as appropriate in light of experience and in response to regulatory or legal developments.

### **3. Consultation Questions**

Feedback on the proposed Sanctions Guidance is requested from interested parties in accordance with the following four questions:

- **Question 1: Do you consider that the proposed Sanctions Guidance provides a clear framework to guide the decision making of Committees/Tribunals?**
- **Question 2: Have we included the sorts of factors in the proposed Sanctions Guidance that you would expect Committees/Tribunals should take into account when deciding which Sanction to impose?**
- **Question 3: Do you consider there is anything missing from the proposed Sanctions Guidance that would improve its effectiveness?**
- **Question 4: Do you have any other comments about the proposed Sanctions Guidance?**

#### **4. Preliminary Impact Assessment**

An Impact Assessment was prepared as part of the FRC reform process which included the proposal that the FRC be provided with powers in respect of regulatory sanctions.

The Impact Assessment concluded that there was not expected to be any additional cost or significant transitional costs associated with the powers. There are no changes to the Impact Assessment as a consequence of the proposed Sanctions Guidance.

A full copy of the original Impact Assessment can be found on the FRC's website:

<http://frc.org.uk/getattachment/ab71a300-1649-4ace-8472-ffeaae1c03db/Proposals-to-Reform-the-FRC-Consultation-Stage-Impact-Assessment.aspx>

## **5. How to respond**

Please respond by 10 July 2013 at the latest. Earlier responses would be appreciated.

Responses should be sent (preferably by email) to:

Sophie Broom, Communications Executive  
FRC  
5th Floor Aldwych House  
71-91 Aldwych  
London WC2B 4HN

Email: [consultations@frc.org.uk](mailto:consultations@frc.org.uk)

Comments will be made publicly available on the FRC's website ([www.frc.org.uk](http://www.frc.org.uk)) unless respondents specifically request otherwise. If you send an email response which includes an automatically generated notice stating that the content is to be treated as confidential you should make clear in the body of your text whether or not you wish your comments to be treated as confidential.

## **Annex A – Proposed Auditor Regulatory Sanctions Guidance**

### **Introduction**

1. This document provides guidance for members of the Financial Reporting Council (“the FRC”) Monitoring Committee (“the Committee”) when considering agreeing Sanctions under paragraph 5.4 and 7.3 of the Auditor Regulatory Sanctions Procedure (“the Procedure”) and the Independent Sanctions Tribunal (“the Tribunal”) when considering the imposition of Sanctions under paragraph 12.5 of the Procedure on Registered Auditors as defined in the Procedure.
2. Terms defined in the Procedure shall have the same meaning in this guidance.
3. This guidance is made by the Conduct Committee of the FRC pursuant to paragraph 3.1(i) of the Procedure which:
  - empowers the Conduct Committee to provide the Committee and the Tribunal with guidance concerning the exercise of their duties under the Procedure; and
  - requires the Committee and the Tribunal to have regard to any such guidance.
4. This document is intended to provide guidance to Committee members and Tribunal members on the approach to be taken when considering whether, and if so, what, sanctions are appropriate in any given case. It is intended to:
  - promote proportionality, clarity, consistency and transparency in decision-making; and
  - ensure that all parties are aware from the outset of the approach likely to be taken by a Committee when agreeing sanctions, or a Tribunal when determining what sanction to impose.

It is important to emphasise that this guidance is advisory – and is not binding on Committees or Tribunals. It is for each Committee to decide what, if any, sanction to agree based on the information provided to it and for each Tribunal to decide what, if any, sanction to impose given the findings it makes in the case that it has heard. Where a Committee or Tribunal decides to depart from the guidance, it should explain its reason for the departure.

5. This guidance is subject to the provisions of the Procedure. In the event of any conflict between the two, the provisions of the Procedure shall prevail.
6. This guidance is a public document. Periodically it will be reviewed and, where appropriate, revised in the light of experience. The guidance cannot deal with every single situation and exceptions will sometimes arise. The guidance should be considered alongside any precedents emerging from relevant cases determined by previous Committees and Tribunals.

## **Aims and Objectives of the FRC's Auditor Regulatory Sanctions Procedure**

7. Sanctions are agreed by the Committee, or imposed by the Tribunal, under the Procedure where a Registered Auditor has failed to comply with the Regulatory Framework for Auditing and:
  - their continued registration or their continued registration without restrictions or conditions could adversely affect a Major Audit Client or any other person; and/or
  - it is necessary to impose a Sanction to ensure that their Statutory Audit Functions are undertaken, supervised and managed effectively.
8. Therefore, in every case where a Registered Auditor is liable to a Sanction, they must have failed to comply with the Regulatory Framework for Auditing, which is defined in Part 1 of the Procedure. In addition to this failure, one of the other two conditions set out at paragraph 4.1 of the Procedure must be satisfied. That is, the continued registration or continued registration without restrictions or conditions of the Registered Auditor must have the potential to adversely affect a Major Audit Client or any other person, and/or it is necessary to impose a Sanction to ensure that their Statutory Audit Functions are undertaken, supervised and managed effectively. This is a two stage test, and the Committee and the Tribunal must ensure that both limbs are satisfied before going on to consider what, if any, sanction to agree or impose. It is not intended that a Registered Auditor would be liable to a Sanction for every technical failure to comply with the Regulatory Framework, but only where a Sanction is appropriate or necessary.
9. In considering whether the alleged failings satisfy the criteria set out in paragraph 4.1, the Committee or Tribunal should have regard to the difference between the Procedure and the disciplinary Scheme. Where the Committee receives a report from AQR and/or further information which indicates that the conduct of a Registered Auditor should be considered in accordance with the provisions of the Scheme or the disciplinary procedures of the RSB, the Committee shall refer the matter to the Conduct Committee under paragraph 5.5(a) of the Procedure. Some failures which may satisfy the criteria under the Procedure will be entirely incompatible with the purposes of the Procedure, for example failures which involve dishonesty or a criminal conviction.
10. In determining the appropriate Sanction, the Committee or Tribunal should have regard to the reasons for imposing Sanctions, by reference to the conditions in paragraph 4.1 of the Procedure, along with the general regulatory objectives of AQR work, namely:
  - to prevent an adverse effect on a Major Audit Client or any other person;
  - to ensure that the Registered Auditor's Statutory Audit Functions are undertaken, supervised and managed effectively;
  - to improve the quality of the performance of Statutory Audit Functions;
  - to deter Registered Auditors from failing to comply with the Regulatory Framework for Auditing;
  - to protect the public from Registered Auditors who have failed to comply with the Regulatory Framework for Auditing;

- to maintain and promote market confidence in the performance of Registered Auditors and their compliance with the Regulatory Framework;
- to declare and uphold proper standards amongst Registered Auditors.

The purpose of imposing Sanctions for failure to comply with the Regulatory Framework for Auditing is not to punish, but to protect the public and the wider public interest. Therefore the Committee or Tribunal's objectives should be to agree or impose the Sanction necessary to achieve the objectives of the Procedure.

11. This guidance has been developed to help Committees and Tribunals achieve these objectives by agreeing and imposing Sanctions which:
- improve the performance of Statutory Audit Functions by the Registered Auditor;
  - are tailored to the facts of the particular case and take into account the nature of the failure and the circumstances of the Registered Auditor concerned;
  - are proportionate to the nature of the failure and the harm or potential harm caused;
  - eliminate any financial gain or benefit derived as a result of the failure;
  - deter the Registered Auditor or others from failing to comply with the regulatory Framework for Auditing.

### **Determination of Sanction**

12. A Committee or Tribunal should consider the full circumstances of each case and the seriousness of the failures involved before determining which Sanction should be agreed or imposed. This guidance considers those factors that may be relevant to a Committee or Tribunal's consideration. The factors are not listed in any kind of hierarchy and it is for a Committee or Tribunal to decide on the weight to be allocated to each factor. The factors listed are not exhaustive; not all of the factors may be applicable in a particular case and there may be other factors, not listed, that are relevant.
13. In deciding which Sanction to agree or impose, a Committee or Tribunal should have regard to the principle of proportionality. In assessing proportionality, a Committee or Tribunal should consider whether a particular Sanction is commensurate with the circumstances of the case, including the seriousness of the failure and the circumstances of the Registered Auditor.
14. The seriousness of the failure should be determined by reference to a number of factors. These include the nature of the failure, the importance of the standard or regulation breached, the level of responsibility of the Registered Auditor and the actual or potential loss or harm caused by the failure. The extent to which intent, recklessness, knowledge of the risks or likely consequences, negligence or incompetence are involved will vary.

### **Sanctions**

15. The Sanctions to which a Registered Auditor shall be liable as set out at paragraph 4.2 of the Procedure are:

- Restrictions and/or Conditions;
- Regulatory Penalty – a fine of an amount determined by the Committee or Tribunal;
- Suspension of Registration;
- Withdrawal of Registration.

### **Combination of Sanctions**

16. Sanctions may not be agreed or imposed in combination, the most appropriate and proportionate Sanction must be determined in isolation, with a Committee or Tribunal considering each of the Sanctions in turn.

### **Summary of Approach to Determining Sanction**

17. It follows, therefore, that the normal approach to determining the Sanction to be agreed or imposed in a particular case should be to:

- Assess the nature and the seriousness of the failure;
- Identify the Sanction (including the range within which any regulatory penalty might fall) that the Tribunal considers potentially appropriate having regard to failure identified in i. above;
- Consider any relevant aggravating or mitigating circumstances and how those circumstances affect the level of Sanction under consideration;
- Consider any further adjustment necessary to achieve the appropriate deterrent effect;
- Consider whether a discount for admissions or settlement is appropriate;
- Decide which Sanction to order and the level/duration of the Sanction where appropriate;
- Give an explanation at each of the six stages above, sufficient to enable the parties and the public to understand the Committee or Tribunal's conclusions.

### **Undertaking the initial assessment of the potential sanctions to determine**

18. In assessing the nature and seriousness of the failure and in determining which sanctions might be appropriate, a Committee or Tribunal will normally consider the factors summarised in the next paragraph. This list is not exhaustive and not all the factors will be applicable in a particular case. A Committee or Tribunal should also consider carefully whether there may be other factors, not listed, that are relevant. Having identified the factors that it regards as relevant, a Committee or Tribunal should decide the relative weight to ascribe to each relevant factor.

19. Factors which may be considered include:

- the financial benefit derived, or loss avoided, whether for or by the Registered Auditor or another, as a result of the failure (for example, this could be quantified in appropriate cases by the fees received by the Registered Auditor);
- whether the failure caused or risked the loss of significant sums of money (for example, this could be quantified in appropriate cases by reference to the reduction in market value);
- whether the failure was intentional or deliberate;

- the nature, extent and importance of the standards or regulations breached;
- whether the failure adversely affect, or potentially adversely affected, a significant number of people in the United Kingdom (including a Major Audit Client, the public, investors or other market users, consumers, employees, pensioners or creditors);
- whether the failure could undermine confidence in the standards in general of Registered Auditors;
- whether the failure involved ethical issues;
- whether similar failures have been identified in previous AQR reports;
- whether the Registered Auditor has failed to comply with any previous written Undertakings;
- the effectiveness of relevant internal procedures, systems or guidance;
- the arrangements for the supervision and management of the performance of Statutory Audit Functions;
- the level of co-operation of the Registered Auditor with the AQR and the Committee.

18. When determining the Sanction to be agreed or imposed, a Committee or Tribunal disregards the fact that sanctions have been, or may be, imposed by another regulator or other authority in respect of the failure or the events related to that failure. A Committee or Tribunal takes account of sanctions that have been, or may be, imposed only when considering a Registered Auditor's financial position.

19. The following sections provide guidance on the factors that a Committee or Tribunal may take into account when consider whether to agree or impose a particular sanction.

## **Restrictions and /or Conditions**

### ***Introduction***

20. A Committee or Tribunal may agree or impose an order restricting the Registered Auditor's practice and/or placing conditions on that practice. A Committee or Tribunal may determine any Restrictions and/or Conditions that it considers, in its absolute discretion, appropriate. Restrictions and/or Conditions may be imposed for such time period as the Committee or Tribunal thinks fit. By way of example and without limitation to the Committee and Tribunal's general discretion, a restriction may be placed on the nature of work undertaken, and conditions may include requiring a Registered Auditor to undertake training programmes, implement policy changes or develop or impose certain supervisory structures.

21. Restrictions and/or Conditions might be most appropriate in cases where there is evidence of a shortcoming in a particular area of practice, or there has been a repeated relatively minor or inadvertent breach of the standards that could be remedied through restrictions and/or conditions. Any Restrictions and/or Conditions should be appropriate, proportionate, workable and measurable, and should not amount to an inability to practise.

## ***Determining Restrictions and/or Conditions***

22. This Sanction is intended to be used by Committees and Tribunals where the circumstances suggest that the public interest would be best served by restricting the Registered Auditor's practice or imposing conditions on that practice with a view to:
- improving the professional competence and performance of the Registered Auditor;
  - ensuring that all partners or personnel receive training in a particular area of practice;
  - ensuring that a Registered Auditor implements organisational or administrative arrangements that would avoid a repetition of the failure;
  - preventing a Registered Auditor from undertaking audits of entities of a particular character that, based on the failures identified, that Registered Auditor is not competent to undertake.
23. The determination of an order imposing restrictions and/or conditions will normally be accompanied by ancillary provisions that address such matters as:
- the period during which any restriction on a Registered Auditor's ability to undertake particular engagements shall remain in effect;
  - the period during which any condition shall remain in effect;
  - any period within which a particular condition must be fulfilled ;
  - the identity of any person or organisation responsible for overseeing compliance with an order;
  - the procedure by which a Registered Auditor may apply to vary or discharge an order.

## **Regulatory Penalty**

### ***Introduction***

24. A Regulatory Penalty may only be used where there are no concerns that a Registered Auditor's continued registration or continued registration without restrictions or conditions could adversely affect a Major Audit Client or any other person. A Regulatory Penalty may only be imposed or agreed where a Committee or Tribunal is satisfied that it will be sufficient to ensure that a Registered Auditor's Statutory Audit Functions are undertaken, supervised and managed effectively. It may be used to mark a Committee or Tribunal's disapproval of the Registered Auditor's failings.

### ***Determining a Regulatory Penalty***

25. In order to determine whether a Regulatory Penalty is appropriate the factors to be considered will normally include whether:
- restrictions and/or conditions, or suspension or withdrawal of registration is more appropriate than a regulatory penalty;
  - the Registered Auditor has derived any financial gain or benefit as a result of the failure;
  - the failure involved or caused or put at risk the loss of significant sums of money; and

- a Regulatory Penalty was agreed or imposed in similar previous cases.

26. In cases where a Committee or Tribunal considers that a Regulatory Penalty is appropriate, it should aim to determine an amount that:

- is proportionate to the failure and all the circumstances of the case;
- will act as an effective deterrent to future failings;
- will promote public confidence in the regulation of Registered Auditors and the way in which failings are addressed;

27. In undertaking this assessment, a Committee or Tribunal will normally take into consideration:

- the seriousness of the failure;
- the size/financial resources of the Registered Auditor and the effect of a Regulatory Penalty;
- the factors set out at paragraph 19.

There is no upper limit on the regulatory penalty that a Committee or Tribunal can impose, however it should be borne in mind that the purpose of a regulatory Sanction is not to punish.

28. The amount of the group audit fee may be a factor to be taken into account when assessing the amount of penalty which would be necessary, in the circumstances of the particular case, to act as a credible deterrent. Where a failing has been identified as part of a firm wide review, it may be that the amount of the revenue generated by the particular department in which the failure was identified, or the audits in which the shortcomings came to light, should be taken into account when determining the size of the Regulatory Penalty.

29. Having assessed the seriousness of the failing, the amount of any penalty will have regard to the Registered Auditor's financial resources.

30. When deciding the level of penalty to determine, a Committee or Tribunal should disregard the possibility that the Registered Auditor may be liable for the costs of the case before a Tribunal.

31. Having arrived at a figure for the Penalty based on the nature and seriousness of the failings, a Committee or Tribunal should consider whether the amount should be adjusted:

- to take account of any aggravating and mitigating factors;
- to ensure the penalty has the necessary deterrent effect; and/or
- to reflect any discount for admissions and/or settlement.

## **Suspension of Registration**

### ***Introduction***

32. A Committee or Tribunal may agree or impose the suspension of a Registered Auditor's registration, where Restrictions and/or Conditions, or a Regulatory Penalty, would not be sufficient to address the Committee or Tribunal's concerns.
33. Suspension of Registration may be an appropriate Sanction where there are such concerns about the Registered Auditor's competence and/or ability to comply with the Regulatory Framework for Auditing that they should not be permitted to undertake Statutory Audit Functions for a particular period. It may also be appropriate where the failure was so serious that it would significantly undermine public and market confidence in the standards of Registered Auditors and suspension is necessary to protect the public and the public interest.
34. A Committee or Tribunal must carefully consider the period of Suspension which is necessary and proportionate, taking into consideration the nature and seriousness of the failure, and the other considerations laid out at paragraph 17. A Committee or Tribunal should also take into account how long it considers it would take the Registered Auditor to rectify the failings identified, in order for it to be appropriate for the period of suspension to come to an end.
35. A Committee or Tribunal may, when giving its reasons, set out certain suggested conditions which it would expect to be fulfilled during the period of suspension.
36. A Committee or Tribunal should take into account that suspension will normally have an effect upon persons employed by the Registered Auditor.

### ***Determining Suspension of Registration***

37. In order to determine whether a period of suspension is appropriate, the factors to be considered include:
  - the extent to which the failure calls into question the competence of the Registered Auditor;
  - whether the failure was deliberate;
  - whether the failure was reckless;
  - the significance of the failure, including the nature and importance of the standards and/or regulations breached;
  - the duration and frequency of the failings;
  - the amount of financial benefit (including avoidance of loss) to the Registered Auditor;
  - whether the failure adversely affected a significant number of people in the United Kingdom (such as Major Audit Clients, investors, employees, pensioners or creditors);

- whether the failure involved or caused or put at risk the loss of significant sums of money;
- whether the failure could undermine confidence in the standards in general of Registered Auditors;
- whether the failure reveals serious or systemic weaknesses in the management systems or internal controls of the Registered Auditor;
- whether it is likely that the same type of failings will recur;
- whether it appears possible to rectify the issues identified within a reasonable time period;
- whether similar failings have been identified in previous AQR reports which the Registered Auditor has failed to address;
- whether the Registered Auditor has failed to comply with previous written Undertakings;
- whether the Registered Auditor has already been subject to regulatory Sanction, whether determined by the FRC under the Procedure, or by the relevant RSB.

## **Withdrawal of Registration**

### ***Introduction***

38. Withdrawal of a Registered Auditor's registration is the most serious Sanction with the most far reaching consequences. Therefore, it should be reserved for the most fundamental breaches of the Regulatory Framework for Auditing, where continued practice would be so damaging to the public, the public interest and market confidence in the standards of Registered Auditors that Withdrawal of Registration is the only appropriate and proportionate Sanction. In practice, it seems likely that Withdrawal of Registration would only be imposed following a tribunal hearing.
39. It may be appropriate to withdraw a Registered Auditor's Registration where a Tribunal considers that there is a lack of willingness to comply with the Regulatory Framework for Auditing, such that it is unlikely to improve and significant and serious failings are likely to continue to be made.
40. Where a Committee is of the opinion that failings are so serious that Withdrawal of Registration may be warranted, it should carefully consider whether it would be appropriate to deal with the matter under the Scheme or the disciplinary procedure of the RSB, and give reasons as to why this is not appropriate.
41. Prior to imposing an order withdrawing registration, all other available Sanction should be considered to ensure that it is the only appropriate Sanction and is proportionate taking into account all the circumstances of the case.

### ***Determining Withdrawal of Registration***

42. Where the failure is fundamentally incompatible with continued Registration, withdrawal is likely to be the appropriate sanction. The tribunal must be satisfied that the Registered Auditor is no longer a proper person to be eligible for appointment as a Statutory Auditor, and there is no prospect of this being remedied in the

foreseeable future. The factors set out at paragraph 37 will normally be relevant when a Tribunal is considering whether to withdraw registration.

43. In particular, the Tribunal must carefully consider whether the failures are capable of remedy, and if so, whether a period of suspension would be appropriate. The Tribunal must satisfy itself that no other Sanction would fulfil the purposes of the Procedure, so that Withdrawal of Registration is the only appropriate and proportionate Sanction available to it.
44. Withdrawal of Registration may only be appropriate and proportionate where the Tribunal the failings are extremely serious and relate to the most fundamental standards and/or regulations, and there are a number of aggravating factors, for example previous Sanctions in relation to similar failings have not resulted in any improvement or the failings took place over a long period of time with the knowledge or complicity of senior management.

### **Agreeing an amended or lesser Sanction**

45. A Committee may decide an amended or lesser Sanction is appropriate, having regard to any further information or representations which it has received, either from the Registered Auditor or from the AQR. A Committee should only accept an amended or lesser Sanction where it is satisfied that this is still proportionate to the failings, and sufficient to protect the public and the public interest.
46. Factors which may be relevant to a Committee's decision to agree a lesser penalty include:
- mitigation offered by the Registered Auditor;
  - explanation as to how the failings came about;
  - further information which lessens the seriousness of the failing.
47. A Committee may consider that, in light of the further information or representations, the original proposed Sanction is not sufficient to address the failings, it may amend the Sanction accordingly and invite the Registered Auditor to agree it.

### **Accepting Undertakings**

48. A Committee or Tribunal may accept written Undertakings from a Registered Auditor. Written Undertakings should only be accepted where this is sufficient to address the concerns of the Committee or Tribunal, to prevent an adverse effect on a Major Audit Client or any other person and to ensure that the Registered Auditor's Statutory Audit Functions are undertaken, supervised and managed effectively. A Committee or Tribunal should be confident that the Registered Auditor will cooperate and fully comply with the proposed Undertakings.
49. By way of example, written Undertakings may include:
- a commitment to impose mandatory training on audit staff;
  - an agreement not to undertake certain types of audit work;
  - a proposal to introduce new policies and procedures to prevent further or similar failings.

50. Where written Undertakings are accepted by a Committee or Tribunal, the Conduct Division of the FRC will monitor compliance with those Undertakings and report to the Monitoring Committee and the relevant RSB as appropriate.

51. Where a Registered Auditor fails to comply with written Undertakings provided to the Committee or Tribunal, the Committee may reopen the matter and the AQR report on compliance with the Undertakings shall be considered, along with the original report to the Committee, in accordance with the terms of the Procedure. Where there has been a deliberate failure to comply with written Undertakings on the part of the Registered Auditor, the Committee should give careful consideration to referral to the Conduct Committee.

### **Variation or revocation of Sanction**

52. A Committee may at any time, with the agreement of the Registered Auditor, make a direction to the relevant RSB to vary or revoke a Restriction, a Condition or a period of Suspension. A Committee should only make such a direction after considering whether:

- the Registered Auditor has taken steps to ensure that the failing will be not be repeated;
- the Registered Auditor has complied with any Restrictions and/or Conditions, or suggestions given by the Committee when imposing a period of Suspension;
- the Sanction in the case of variation, or any Sanction in the case of revocation, is no longer required;
- the varied Sanction, if applicable, is sufficient to protect the public and the public interest.

### **Other factors to be taken into account when determining the Sanction to be imposed**

53. In the course of this guidance reference has been made to various factors that Tribunals should consider when determining the level of Sanction to impose. The characteristic of those factors are discussed below.

### ***Intent***

54. Whether a Committee or Tribunal considers that the failure was intentional will be a material factor when determining any Sanction to be imposed. Where a Committee is of the opinion that a failure was intentional, careful consideration should be given as to whether it would be appropriate to refer the matter to the Conduct Committee.

55. Factors tending to show that the failure was intentional include where:

- the Registered Auditor's senior management or a responsible individual intended or foresaw that the likely or actual consequences of their actions or inaction would amount to a failure to comply with the standards or regulations;

- the senior management or a responsible individual permitted the failings to continue notwithstanding that they knew that their actions breached the standards or regulations or the management or internal control systems;
- the senior management or a responsible individual was influenced by a belief that the failings would be difficult to detect;
- the senior management or a responsible individual deliberately took decisions or allowed action or inaction knowing that they or others were acting outside their field of competence;
- the Registered Auditor intended to benefit financially from the failure;
- the senior management or a responsible individual repeated the failure, or allowed it to be repeated, notwithstanding being aware that to do so would involve breaching the standards or regulations.

### **Reckless**

56. A Committee or Tribunal may consider that a Registered Auditor acted recklessly if the senior management (i) knew that a proposed course of action or inaction might involve a breach of the Regulatory Framework, and (ii) proceeded nevertheless.

### **Aggravating and Mitigating Factors**

57. Having assessed the seriousness of the failure and reached a view on the Sanction that would be appropriate, a Committee or Tribunal may consider whether to adjust that Sanction to reflect any aggravating or mitigating factors that may exist (to the extent those factors have not already been taken into account in the assessment of the seriousness of the failure). A Committee must remember that if the aggravating factors are such that it would be appropriate that the conduct of the Registered Auditor be considered in accordance with the provisions of the Scheme or the disciplinary procedures of the relevant RSB, the Committee should refer the matter to the Conduct Committee.

58. Examples of events or behaviour that a Committee or Tribunal may conclude aggravated the failure, and so should be taken into account when deciding the Sanction to be agreed or imposed, include where:

- the Registered Auditor failed to cooperate with, or hindered, the inspection by the AQR;
- senior management were aware of the failure, or that such a failure was likely to occur, but failed to take steps to stop or prevent the failure;
- senior management or a responsible individual sought to conceal or reduce the risk that the failure would be discovered;
- the Registered Auditor facilitated wrongdoing by a client;
- similar failings were identified by a previous AQR report;
- no remedial steps have been taken since the failure was identified;
- the failings were repeated and/or occurred over an extended period of time;
- the Registered Auditor has failed to comply with written Undertakings given to the Committee, the Tribunal or the relevant RSB;

- the Registered Auditor has previously been subject to Regulatory Sanction, either in accordance with the Procedure or by the relevant RSB. The more serious and/or similar the previous failure, the greater the aggravating factor.

59. Examples of events or behaviour that a Committee may conclude mitigate the failure, and so should be taken into account when deciding the Sanction to be agreed or imposed, include where:

- the Registered Auditor cooperated during the AQR inspection and the Monitoring Committee consideration of the AQR report;
- the Registered Auditor had taken appropriate steps to stop or prevent the failings;
- the Registered Auditor had structures and policies in place
- the Registered Auditor has shown awareness of the relevant standards and
- appropriate remedial steps were taken once the failing was identified;
- the Registered Auditor was deliberately misled by a third party;
- the failing was an isolated event that is most unlikely to be repeated;
- the Registered Auditor did not stand to gain any profit or benefit from the failure;
- the Registered Auditor has a good compliance history;
- the Registered Auditor has demonstrated contrition.

### ***Adjustment for deterrence***

60. If the Committee or Tribunal considers that the Sanction arrived at, after making any adjustment to reflect any aggravating and mitigating factors, is insufficient to deter the Registered Auditor, or other Registered Auditors, from making further or similar failings, the Committee or Tribunal may adjust the Sanction to ensure that the intended deterrent effect will be achieved.

61. Examples of the circumstances where a Committee or Tribunal may consider it appropriate to make such an adjustment include where a Committee or Tribunal considers that:

- the Registered Auditor already has a Regulatory record for failings of a similar nature;
- Sanctions imposed previously in respect of similar failings have failed to achieve an improvement in compliance with the Regulatory Framework for Auditing by the Registered Auditor;
- there is a risk of similar failings in the future, whether by the Registered Auditor, or by other Registered Auditors, in the absence of a sufficient deterrent;
- the Sanction is too small to meet the objective of credible deterrence.

## ***Discount for Admissions and/or Settlement***

### *Settlement – agreeing a sanction with a Committee*

62. Where a Registered Auditor agrees a Sanction with a Committee, whether as a result of the Committee's original notice, or following correspondence and suggestion of an amended or lesser Sanction, it is appropriate to adjust the amount of any Regulatory Penalty and/or other Sanction that might otherwise have been imposed to reflect the stage at which agreement was reached.
63. Normally it will be inappropriate to reduce the period during which Restrictions and/or Conditions apply, or a period of Suspension, to reflect an agreement because the primary purpose of such a Sanction is to protect the public. Therefore, any adjustment will generally apply only to a Regulatory Penalty to be imposed.
64. For the purpose of providing guidance on the scale of any settlement adjustment, the FRC recommends that if a Sanction is agreed with a Committee, a reduction of between 20 and 35% may be appropriate.

### *Admissions before a Tribunal*

65. Where a Registered Auditor makes an admission in respect of some or all of any alleged particulars of fact and/or alleged failures to comply with the Regulatory Framework, it is appropriate that any Regulatory Penalty and/or other Sanction that might otherwise be determined should be adjusted to reflect the extent significance and timing of those admission.
66. Where an admission is made voluntarily and prior to the commencement of the hearing, it will be appropriate to consider a more significant adjustment.
67. A Tribunal, and a Committee where agreeing a Sanction, must remain satisfied that any adjusted Sanction is sufficient to protect the public and the wider public interest.

## **Costs**

68. Costs may only be ordered by a Tribunal, following a finding that a Registered Auditor has failed to comply with the Regulatory Framework for Auditing. Costs cannot be ordered by a Committee where a sanction has been agreed.
69. A Tribunal may order that the Registered Auditor be required to pay the whole or part of the costs of the hearing. This may be in addition to any Sanction determined or Undertaking accepted, or a Tribunal may make no determination against the Registered Auditor except for the payment of costs, if it considers that to be appropriate in all the circumstances. The amount to be paid by the Registered Auditor and the time for payment shall be determined by the Tribunal.
70. When determining whether to order costs, and the amount of costs to be paid, a Tribunal may take account of:

- a Registered Auditor's financial position and the impact of any Regulatory Penalty that forms part of the proposed Sanction; and
- any arrangements that would result in part or all of any award of costs being paid or indemnified by insurers.

**Effective Date**

This guidance was issued by the Conduct Committee on ... and applies with immediate effect.



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