Guidelines on Enforcement Measures against Recognised Supervisory Bodies and Recognised Qualifying Bodies

for breach of the statutory requirements and obligations in relation to the regulation of statutory audit set out in Part 42 Companies Act 2006
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Introduction

1. Part 42 of the Companies Act 2006 (the ‘Act’) imposes certain requirements and obligations on Recognised Supervisory and Qualifying Bodies (as defined by the Act) including requirements to participate in certain arrangements and obligations to maintain certain rules and practices (as set out in Schedules 10 and 11) when regulating statutory auditors (collectively, the ‘Requirements’). The Requirements are designed to secure that only persons who are properly supervised and appropriately qualified are appointed as statutory auditors, and that those persons carry out audits properly, with integrity and with a proper degree of independence.

2. Part 42 of the Act confers certain powers and functions regarding the oversight and regulation of statutory auditors upon the Secretary of State (the ‘Part 42 Powers’). The Part 42 Powers include the power to impose Enforcement Measures upon the Recognised Bodies, pursuant to section 1225 of the Act (the ‘Enforcement Measures’) in the event of non-compliance by Recognised Bodies with the Requirements.

3. By section 1252 of the Act and by the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012, the Secretary of State has delegated its Part 42 Powers to the Financial Reporting Council Limited (the ‘FRC’). The FRC Board is responsible for the exercise of the Part 42 Powers.

4. In all cases, the decision to impose Enforcement Measures is taken by the FRC in accordance with the provisions of Part 42 and the FRC applies these Guidelines to ensure that its decisions are fair and consistent. The Guidelines are furthermore intended to make transparent the principles the FRC applies when carrying out its responsibilities.

Aims and Objectives

5. The FRC’s aims and objectives if applying any Enforcement Measures are:
   • proportionate and effective regulation;
   • promotion of timely compliance by a Recognised Body with the Requirements;
   • deterrence of continuing or future non-compliance;
   • a transparent and consistent approach by the FRC when imposing any Enforcement Measure.

The Enforcement Measures are not intended to be compensatory or punitive measures.

Enforcement Measures and the FRC’s approach

Voluntary Dialogue

6. The FRC welcomes the important role played by the Recognised Bodies in carrying out the Requirements and therefore the FRC will usually first attempt to work with the Recognised Body to correct non-compliance by co-operation unless there is a compelling reason why this is not considered appropriate in a particular case.

7. If compliance with the Requirements is not achieved by this approach within a reasonable timeframe and to the FRC’s reasonable satisfaction, the FRC will next move to considering whether to impose any of the Enforcement Measures, as set out below.
Direction

8. The FRC is empowered to order a Recognised Body to comply with any direction that it considers necessary to secure satisfaction or compliance with a Requirement or to mitigate or deter reoccurrence of such non-compliance, in accordance with the procedure required by section 1225B.

9. The FRC will usually only consider imposing a Direction where: the Recognised Body has not already rectified the non-compliance in question either on its own initiative or upon the request of the FRC to rectify the non-compliance on a voluntary basis; and

   • the public interest would be well served by requiring the Recognised Body to implement organisational or administrative arrangements that would avoid future non-compliance;

   • the non-compliance follows previous examples of non-compliance.

Compliance Order

10. If the Recognised Body does not comply with the Requirements or with a Direction issued by the FRC, the FRC is empowered to apply to the High Court under section 1225C of the Act for a Compliance Order.

11. The FRC will usually only consider applying for a Compliance Order where:

   a. the Recognised Body has not complied with or successfully challenged a Direction which the FRC has issued in accordance with these Guidelines; and

   b. it is proportionate to the non-compliance in question to apply for a Compliance Order, having regard to the factors listed in paragraph 5; and/or

   c. there is likely to be an imminent and significant adverse effect upon the regulation of statutory audit, statutory audit clients and any others, should the non-compliance continue.

Financial Penalty

12. The FRC is empowered to impose a Financial Penalty pursuant to section 1225D and 1225E of the Act, if a Recognised Body:

   a. breaches a Requirement; and/or

   b. has not complied with any Enforcement Measure imposed by the FRC pursuant to section 1225 of the Act.

13. The FRC will usually only consider imposing a Financial Penalty in addition to other Enforcement Measures in exceptional circumstances and where:

   a. the non-compliance has been repeated or is continuing;

   b. a Direction or Compliance Order has not been or would not be sufficient to address the non-compliance in question; and/or

   c. it is considered that imposing a Financial Penalty is reasonable, proportionate and justified in the aim of achieving satisfactory compliance by the Recognised Body with the breached Requirement and/or in deterring future non-compliance by the Recognised Body or by other Recognised Bodies.
14. The FRC will not usually impose a Financial Penalty:

   a. where the Recognised Body complied with the Requirement (in respect of which a Financial Penalty is being considered) before the FRC issued a Notice of Proposed Penalty;

   b. where the Recognised Body complied with the Requirement in respect of which a Direction was issued before the FRC issued a Notice of Proposed Direction;

   c. in isolation (i.e. without a Direction or Compliance Order) as it will normally be in the public interest for any non-compliance warranting the imposition of a Financial Penalty to be accompanied by some corrective action.

15. Financial Penalties imposed and collected by the FRC will be collected on behalf of and held for the account of the Secretary of State.

**Approach for deciding which Enforcement Measure to Apply**

16. When determining the appropriate Enforcement Measure(s), the FRC should have regard to the aims of the Act, the Aims and Objectives set out in paragraph 5 of these Guidelines and the FRCs approach as set out in paragraphs 6-15 of these Guidelines. The FRC should only apply Enforcement Measures if proportionate to do so and which are tailored to the facts of the particular case.

17. When assessing proportionality, FRC should consider whether Enforcement Measures at all as well as the particular Enforcement Measure(s) under consideration is/are commensurate with the circumstances of the case, including:

   a. the seriousness of the non-compliance;

   b. the circumstances (including the financial circumstances where a Financial Penalty is considered) of the Recognised Body concerned;

   c. the potential harm to the public.

18. When determining which, if any, Enforcement Measure(s) to impose, the FRC will usually assess:

   a. the nature and the seriousness of the non-compliance by considering the following (non-exhaustive) factors below:

      • the nature, extent and importance of the Requirements breached;

      • what was the harm caused?

      • did or could the non-compliance adversely affect a significant number of people in the United Kingdom (such as the public, investors or other market users, consumers, clients, employees, pensioners or creditors)?

      • has or could the non-compliance undermine the purpose or effectiveness of the regulatory arrangements being carried out by the Recognised Body?

      • has or could the non-compliance undermine confidence in the regulation of statutory audit in the United Kingdom and/or the statutory audit profession generally?
b. the relevant circumstances of the non-compliance, which may include considering the following (non-exhaustive) examples of aggravating or mitigating factors:

- was the non-compliance deliberate, reckless or accidental?
- the period during which non-compliance continued;
- the likelihood of repeated or continuing non-compliance;
- the Recognised Body’s compliance history;
- what steps were taken before consideration of Enforcement Measures to address the non-compliance?
- did the Recognised Body self-notify?
- was the Recognised Body acting in accordance with the requirements of another statutory oversight body?
- was the Recognised Body acting in accordance with external advice?

19. Enforcement Measures may be imposed singly or in combination. Financial Penalties will usually only be imposed in combination with another Enforcement Measure.

20. The FRC should give sufficient explanation of its approach for deciding which Enforcement Measure(s) to apply (and in the case of a Financial Penalty, for each of the Steps set out in Appendix 2), to enable the Recognised Body and the public to understand the FRC’s conclusions.

**Governance and Procedure**

21. Voluntary dialogue with Recognised Bodies regarding non-compliance with the Requirements will be conducted by the FRC’s Professional Oversight Team and reported to the Conduct Committee.

22. Decisions to impose Enforcement Measures will be taken by the FRC Board upon the advice and recommendation of the Conduct Committee. A copy of the FRC’s governance procedures is available at [https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Governance-Bible.pdf](https://www.frc.org.uk/Our-Work/Publications/FRC-Board/Governance-Bible.pdf).

23. When considering whether it is appropriate to impose Enforcement Measures, the Conduct Committee and the Board will have regard to these Guidelines.

24. When applying Enforcement Measures, the FRC will follow the procedures set out in the Act and summarised in Appendix 1.

25. If the FRC decides to impose a Financial Penalty, it will usually follow the three-step approach set out in Appendix 2.
Publication

26. The FRC will publish details of the imposition of Enforcement Measures as required by the Act and as set out in Appendix 1 (Procedure). In summary:

   a. the FRC is required to publish a Direction Decision Notice and a Penalty Decision Notice. It will do so in such manner as the FRC considers appropriate for bringing the Direction to the attention of persons likely to be affected. Where a Direction Decision Notice or a Penalty Decision Notice are challenged, the FRC may consider it appropriate to delay publication pending resolution of that challenge;

   b. the FRC may publish the outcome of a successful application by the FRC for a Compliance Order;

   c. publication will include an announcement on the FRC website and a link to the Decision Notice in question;

   d. save where there is a compelling reason for urgent publication, such as safeguarding the public interest, parties named in a proposed announcement on the FRC website will usually be given a minimum of 24 hours’ advance notice of publication. Amendments will not generally be accepted except in relation to matters of factual accuracy.

Approved by the FRC Board on 23 April 2015
Appendix 1

Procedure

This Appendix notes (but should not be relied upon to the exclusion of) the procedural requirements set out in the Companies Act 2006 and in the Civil Procedure Rules. In the event of any inconsistency between those procedural requirements and this Appendix, the Companies Act 2006 and the Civil Procedure Rules shall prevail.

1. Direction

1.1. Issue a Notice of Proposed Direction which is compliant with section 1225B and:
   a. identifies the requirement or obligation which has prompted the FRC’s issuance of the Proposed Direction;
   b. sets out the FRC’s reasons for believing there has been non-compliance;
   c. encloses a copy of the Proposed Direction;
   d. states the intention to impose the Proposed Direction;
   e. allows the Recognised Body at least 28 days to make written representations;
   f. may also be expressed to be a pre-action letter for the purposes of later compliance with the Civil Procedure Rules Protocol on Pre-Action Conduct (the Protocol), should the FRC later choose to apply to the Court for a Compliance Order (see para 2 below).

1.2. Consider any written representations which the Recognised Body has made within the period specified in the Notice of Proposed Decision.

1.3. Issue a Direction Decision Notice which is compliant with section 1225B and contains:
   a. a copy of the Direction;
   b. the time period for compliance with the Direction;
   c. the period during which any limitation on the Recognised Body’s ability to undertake particular engagements shall remain in effect;
   d. the FRC’s reasons for deciding to impose the Direction (the reasons should ideally reference any written representations submitted in time by the Recognised Body);
   e. the identity of any person or organisation responsible for overseeing compliance with a Direction.

1.4. The FRC shall publish a Direction Decision Notice in such manner as the FRC considers appropriate for bringing the Direction to the attention of persons likely to be affected.

2. Compliance Order
2.1. Any application to the Court must be made pursuant to the applicable Civil Procedure Rules (the ‘CPR’), and the parties will be expected by the Court to have complied with the Practice Direction on Pre-action Conduct (the ‘Protocol’) or to explain their reasons for non-compliance.

2.2. If the FRC has already issued a Notice of Proposed Direction or a Direction Decision Notice (which is compliant with and is expressed to be written pursuant to the Protocol), the FRC should consider if a separate Protocol Letter (see below) is still required.

Protocol Letter:

2.3. Before applying for a Compliance Order, the FRC will, where possible and appropriate, take reasonable and proportionate steps in the circumstances to comply with the Protocol including:

a. setting out sufficient, written detail of the matter to the Recognised Body (a ‘Protocol Letter’);

b. allowing the Recognised Body at least 28 days to provide a full response (longer if complex issues are at stake);

c. giving proper consideration to alternative dispute resolution for example by way of discussion and negotiation.

2.4. The Protocol Letter should include:

a. the basis of the FRC’s intended application;

b. a clear summary of the facts;

c. what the FRC requires the Recognised Body to do to avoid the application;

d. identification of the essential documents (if any) relied upon by the FRC;

e. identification of any additional information required by the FRC;

f. the FRC’s proposal for a suitable alternative form of resolution (if any);

g. express reference to the Protocol, including the Court’s powers to impose Enforcement Measures for non-compliance and that if the Recognised Body does not respond, the FRC may issue the application and the Recognised Body’s costs risk may therefore be increased.

2.5. Where the FRC has not complied with the Protocol, it should consider if:

a. it is, in the circumstances, still reasonable to proceed with the application; and

b. there is a risk of an adverse costs order.

Application for Compliance Order

1 Including but not limited to CPR parts 8 and 49 as at the date of these Guidelines.
2.6. Any application to the Court for a Compliance Order will be made under the applicable CPR requirements.2

2.7. In accordance with the current Civil Procedure Rules in force, the Recognised Body shall have 14 days from service in which to file an acknowledgement of service (and any supporting evidence), (or such further period as permitted by the applicable Civil Procedure Rules or otherwise with the permission of the Court).

2.8. Where the FRC is granted a Compliance Order by the Court, it will usually ask the Court to order the Recognised Body to pay the FRC’s costs.

2.9. The Recognised Body may appeal a Compliance Order with the Court’s permission and in accordance with the processes set out in the Civil Procedure Rules or otherwise permitted by the Court.

2.10. The FRC may, at its discretion, but is not required to, publish the outcome of a successful application for a Compliance Order. The FRC will not usually announce the fact or outcome of an unsuccessful application for a Compliance Order.

3. **Financial Penalty**

3.1. Issue a Notice of Proposed Penalty which:
   a. identifies the requirement or obligation;
   b. identifies the outstanding non-compliance as at the date of the Notice of Proposed Penalty, together with the FRC’s reasoning;
   c. states the amount of the Financial Penalty proposed;
   d. states the intention to impose the Proposed Penalty;
   e. allows the Recognised Body at least 28 days to make written representations.

3.2. Consider any written representations which the Recognised Body has made within the period specified in the Notice of Proposed Penalty.

3.3. Issue a Penalty Notice Decision stating:
   a. that the FRC has imposed a penalty on the Recognised Body and the amount;
   b. the information at para 3.1a-c above;
   c. the time period for payment which may not be less than 3 months from the date of the Penalty Notice Decision.

3.4. The FRC shall publish a Penalty Decision Notice in such manner as the FRC considers appropriate for bringing the penalty to the attention of persons likely to be affected.

**Appeals**

2 As at the date of these Guidelines, pursuant to CPR Part 49 by filing and service a CPR Part 8 claim form (together with supporting evidence)
3.5. The Recognised Body may appeal a Financial Penalty within 3 months of the date of the Penalty Notice Decision by application to the Court pursuant to section 1225F of the Act, on any of the following grounds:

a. before the FRC issued the Proposed Penalty Notice, the requirement was satisfied or the obligation had been complied with;

b. where the FRC has imposed a Financial Penalty for failure to comply with a Direction issued pursuant to these Enforcement Measures, the requirement or obligation had been satisfied before the FRC issued the Notice of Proposed Direction;

c. the FRC failed to comply with the section 1225E procedure before issuing a Financial Penalty (see the guidance at paras 3.1-3.3 above);

d. the amount of the Financial Penalty is unreasonable;

e. the timescale for payment required by the FRC is unreasonable.

3.6. Where an appeal is made, the Penalty is not required to be paid until the appeal has been determined or withdrawn, but interest may accrue upon the unpaid Financial Penalty, at the Court's discretion.

**Further enforcement**

3.7. Where a Financial Penalty has not been paid or appealed by the Recognised Body within the required timescales, the FRC may recover the Financial Penalty and any interest awarded by the Court by way of a debt action.
Appendix 2

Approach for deciding level of a Financial Penalty

Step 1: Determine level of any Financial Penalty to be imposed

1. In cases where FRC considers that a Financial Penalty is reasonable, proportionate, not punitive and therefore is justified in the aim of achieving satisfactory compliance by the Recognised Body, it should aim to impose a Financial Penalty that:

   • is proportionate to the non-compliance and all the circumstances of the case;
   • will act as a credible deterrent to future non-compliance; and
   • will promote public confidence in the regulation of statutory audit and in the way in which non-compliance is addressed.

2. The Financial Penalty should be set at an amount relating to the seriousness of the non-compliance (which may then be adjusted by Steps 2 and 3).

3. When assessing the starting point for an amount to reflect the seriousness of the non-compliance the FRC will usually:

   a. Determine the figure based on a percentage of the Recognised Body’s total audit-related income from its Members and Member Firms which shall be subject to a deemed minimum of £300,000 (the ‘Relevant Audit Fee Income’):

      i. where there is a single event of non-compliance the Relevant Audit Fee Income will be based on the fees collected by the Recognised Body in the 12 months preceding the event of non-compliance;
      ii. where there has been repeated non-compliance, the FRC may extend this to the period starting 12 months before the first date of non-compliance until the date of the last non-compliance;
      iii. where the non-compliance is continuing, the FRC may calculate the non-compliance as at the date of the FRC’s Penalty Notice Decision and add a daily rate of interest to act as a credible deterrent against continuing non-compliance. Such daily interest will not contribute to the maximum Financial Penalty set out above.

   b. Having determined the Relevant Audit Fee Income, the FRC will usually then decide on the percentage of that income which will form the basis of the penalty. In making this determination the FRC will consider the seriousness of the non-compliance and choose a percentage between 0% and 10%. This range is divided into 3 fixed levels which reflect, on a sliding scale, the seriousness of the non-compliance. The more serious the non-compliance, the higher the level:

      Level 1 – 0-1%
      Level 2 – 2-5%
      Level 3 – 6-10%

   c. In determining which level is most appropriate, the FRC will first identify the exceptional seriousness of the non-compliance in question and then assess whether the seriousness should attract a Level 1, 2 or 3 starting point by taking into account the impact and nature of the non-compliance and whether the non-compliance was deliberate or reckless.
d. Factors relating to the **impact** of the non-compliance include:

   i. the effect on the quality of statutory audit;
   ii. the risks posed to statutory audit clients of the Recognised Body's Members or Member Firms;
   iii. level of the competitive advantage or any other benefit gained or loss avoided by the Recognised Body;
   iv. the aims of Part 42 of the Act.

e. Factors relating to the **nature** of the non-compliance include:

   i. the nature of the Requirement(s) and of the non-compliance;
   ii. the frequency of such non-compliance.

f. Factors tending to show the non-compliance was **deliberate** include where the Recognised Body:

   i. intended or foresaw that the likely or actual consequences of its actions or inaction would result in non-compliance;
   ii. gained or intended to gain a competitive advantage for the Recognised Body or its Members;
   iii. intended to benefit financially from the non-compliance, including by costs-saving;
   iv. sought to avoid or reduce the risk of the non-compliance being detected;
   v. repeated the non-compliance.

g. Factors tending to show the non-compliance was **reckless** include where the Recognised Body:

   i. appreciated there was a risk that its actions or inaction could result in non-compliance and failed adequately to mitigate that risk;
   ii. was aware that there was a risk that his actions or inaction could result in non-compliance but failed to check if it was acting in accordance with internal procedures.

h. Factors which are likely to be considered Level 3 factors include:

   i. risk to the system of statutory audit and/or the protection of the public;
   ii. damage to public confidence in the quality of the regulation of statutory audit;
   iii. deliberate non-compliance;
   iv. a high number or percentage of Members or Member Firms benefitting unfairly from or being disadvantaged by the non-compliance.

i. Factors which are likely to be considered Level 1 or 2 factors include:

   i. negligible or no risk to the system of statutory audit and/or the protection of the public;
   ii. negligible or no damage to public confidence in the quality of the regulation of statutory audit;
   iii. negligent or inadvertent non-compliance.

4. When assessing a Financial Penalty overall, the FRC should not take into account its costs in investigating the non-compliance or discharging its Part 42 Powers.

5. Having arrived at a proposed Financial Penalty following Step 1, the FRC will usually next consider whether the proposed Enforcement Measure and/or proposed Financial Penalty should be adjusted in Steps 2 and 3.
Step 2: Make an adjustment for aggravating or mitigating circumstances

6. The FRC may increase the proposed Financial Penalty if the FRC considers that the Recognised Body’s behaviour aggravated the non-compliance. Examples include:
   - the Recognised Body was or should have been aware of the issue and failed to bring the non-compliance to the attention of the FRC quickly, effectively or completely;
   - the Recognised Body failed to cooperate with, or hindered, the investigation of the non-compliance by the FRC;
   - no remedial steps have been taken since the non-compliance was identified, either on the Recognised Body’s own initiative or as directed by the FRC;
   - the non-compliance was repeated and/or occurred over an extended period of time;
   - the non-compliance was committed with a view to profit (or avoidance of loss);
   - the Recognised Body facilitated wrongdoing by a Member or a Member Firm;
   - the Recognised Body’s non-compliance facilitated a Member or Member Firm acting without the necessary authorisations, licences or registrations;
   - the FRC has previously brought to the Recognised Body’s attention, including by way of a private advice or warning, issues similar or related to the conduct that gave rise to the finding of non-compliance in respect of which the Financial Penalty is to be imposed.

7. The FRC may decrease the proposed Financial Penalty if the FRC considers that the Recognised Body’s behaviour mitigated the non-compliance. Examples include:
   - the Recognised Body brought the non-compliance to the FRC’s attention quickly, effectively and completely;
   - the Recognised Body cooperated during the FRC’s investigation of the non-compliance;
   - the Recognised Body was aware of the non-compliance or that such non-compliance was likely to occur, and took appropriate steps to try to stop or prevent the non-compliance and/or mitigate its impact;
   - the Recognised Body took appropriate remedial steps once the non-compliance was identified, irrespective of whether such steps were taken on the Recognised Body’s own initiative or that of the FRC;
   - the non-compliance was an isolated event that is unlikely to be repeated;
   - the Recognised Body did not stand to gain any competitive advantage, profit or other benefit from the non-compliance; the Recognised Body has a good compliance history.

8. Self-reporting non-compliance to the FRC will usually attract greater credit than co-operation which has been prompted by the FRC’s intervention.

Step 3: Adjust for deterrence

9. If the FRC considers that the proposed Financial Penalty arrived at, after Step 2, is insufficient to deter the Recognised Body or other Recognised Bodies, from committing further or similar non-compliance, the FRC may increase the proposed Financial Penalty to ensure that the intended deterrent effect will be achieved.
10. Examples of the circumstances where FRC will usually consider it appropriate to make such an adjustment include where FRC considers that:

- the Recognised Body already has a record for non-compliance of a similar nature;
- enforcement measures imposed previously in respect of similar non-compliance have failed to achieve an improvement in compliance with the Requirements;
- there is a risk of similar non-compliance in the future, whether by the Recognised Body in question or by other Recognised Bodies, in the absence of a sufficient deterrent;
- the Financial Penalty is considered too small to meet the objective of credible deterrence.

**Step 4: Sacrifice of any financial benefit derived by way of non-compliance**

11. Where the Recognised Body has derived any financial benefit as a result of the non-compliance (i.e. by generating revenue or saved expenditure) it will usually be deprived of an equivalent amount and such equivalent amount may be added to the Proposed Financial Penalty arrived at after Steps 1 to 3.