

Independent review of the Financial Reporting Council's Enforcement Procedures Sanctions

Review Panel Report

October 2017

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1. Introduction

- 1.1 The Financial Reporting Council (“FRC”) is the UK’s independent regulator responsible for promoting transparency and integrity in business. The FRC appointed us, the Review Panel, to conduct an independent review of the sanctions imposed under its enforcement procedures (“the Review”). The FRC decided to commission the Review for two reasons. Firstly, it sought to respond to stakeholder feedback that the sanctions imposed under the FRC’s enforcement procedures were too low; secondly it believed that the Review was timely as the FRC approached its one-year anniversary as competent authority. This is our report that sets out our findings following the Review.

Terms of Reference for the Review

- 1.2 The background, scope and purpose of the Review were as set out in the Terms of Reference for the Review as follows:

“Background

The FRC administers a number of enforcement procedures in accordance with its various responsibilities, including its statutory responsibilities. These include the Accountancy Scheme, the Actuarial Scheme, the Audit Enforcement Procedure (AEP), the Auditor Regulatory Sanctions Procedure (ARSP) and the Crown Dependencies Recognised Auditors Regulatory Sanctions Procedure (CD RARSP). Each of these procedures set out a range of sanctions available to the applicable decision maker and are supported by guidance issued by the FRC’s Conduct Committee. The guidance sets out the reasons for imposing sanctions i.e. not to punish but to protect the public and wider public interest including through deterrence, the maintenance and promotion of confidence in the profession and the declaration and upholding of proper standards amongst members of the profession.

Scope and Purpose

The review will consider with reference to the Accountancy Scheme, the AEP and the Actuarial Scheme:

- whether the reasons for imposing sanctions (articulated in the Sanctions Guidance under the Accountancy and Actuarial Schemes and the Sanctions Policy under the AEP) remain appropriate;*
- the fairness and the effectiveness of the range of sanctions available under the above enforcement procedures;*
- whether the financial penalty sanctions are adequate to deter and protect as articulated in the sanctions guidance or, having regard to fairness, should they be strengthened e.g. by the inclusion of a tariff in the guidance;*
- the appropriateness of the remainder of the supporting policy and guidance material.”*

The FRC enforcement procedures considered by the Review

- 1.3 The FRC's longest established procedures are the *Accountancy Scheme* and the *Actuarial Scheme*, referred to collectively as "the Schemes". These are contractual arrangements entered into by the professional bodies identified in the Schemes. The FRC Conduct Committee has issued the *Sanctions Guidance* in support of the Accountancy Scheme, and the *Actuarial Scheme Sanctions Guidance* in support of the Actuarial Scheme. They are in similar terms and although for convenience we often refer in this report simply to the Sanctions Guidance, our observations and recommendations have equal applicability to the Actuarial Scheme Sanctions Guidance, save for references to "Member Firms".¹
- 1.4 Much more recently, and to implement its enforcement responsibility as competent authority for audit in the UK, as set out in the *Statutory Auditors and Third Country Auditors Regulations 2016* ("SATCAR"), the FRC has introduced its *Audit Enforcement Procedure* ("AEP"), which has only been in operation since 17 June 2016. The *Sanctions Policy (Audit Enforcement Procedure)* supports the AEP. We refer to it as "the Sanctions Policy". It is in similar terms to the Sanctions Guidance. To date, no sanctions have been imposed under this procedure.
- 1.5 The nature of the conduct covered by the Schemes and the AEP differs. A Member or Member Firm is liable to investigation under the Accountancy Scheme where the "matter raises or appears to raise important issues affecting the public interest in the UK" and "there are reasonable grounds to suspect that there may have been Misconduct",² defined as "an act or omission or series of acts or omissions by a Member or Member Firm in the course of his or its professional activities...or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession."³ Although many of the cases that have come before FRC Tribunals relate to audits, the Accountancy Scheme is not so limited. The Actuarial Scheme applies only to Members of the Participants in the Scheme (currently only the Institute and Faculty of Actuaries ("IFoA")). The definition of the conduct within its scope is similar save for the absence of reference to Member Firms.
- 1.6 The AEP is concerned with breaches by Statutory Auditors and Statutory Audit Firms of a "Relevant Requirement" where those matters are retained by the FRC.⁴ Relevant Requirement is defined in the AEP as having the meaning set out in regulation 5(11) or regulation 11(5)(b) of SATCAR. The definition, and the matters to which the definition refers, are complex; but it is apparent that the AEP embraces a wider range of failings than the Accountancy Scheme and would include failings of a lower level of

¹ All the enforcement procedures and supporting documents including the Sanctions Guidance and the Sanctions Policy can be found on the FRC's website; <http://www.frc.org.uk/about-the-frc/procedures-and-policies/enforcement-procedures>

² Paragraph 5(1) of the Accountancy Scheme.

³ Paragraph 2(1) of the Accountancy Scheme.

⁴ Such matters include: Public Interest Entities (as defined in regulation 2 of SATCAR), AIM companies with an average three year market capitalisation in excess of €200m, Lloyds Syndicates and investigations which the FRC may reclaim from the RSBs from time to time ("Reclaimed Matters"). See SATCAR, the [Secretary of State Direction under regulation 3\(12\) of SATCAR 2016](#) and the [Delegation Agreements between the FRC and the RSBs](#).

seriousness. It would, for instance, cover a failure to comply with the standards of professional competence, due care and professional scepticism determined by the FRC or the supervisory body of which the auditor is a member, without the qualification that the failure should fall “significantly short” of those standards.

- 1.7 One respondent suggested that there should be greater clarity and focus on the behaviours which were properly the subject of disciplinary and enforcement proceedings and sanctions. We do not regard this issue as within our remit, and are, in any event, sceptical as to whether further guidance is needed given that the matters covered by the AEP are derived from SATCAR and the definition of Misconduct (which requires a high level of fault) is necessarily broad.⁵
- 1.8 Both the Sanctions Guidance and the Sanctions Policy are advisory only and are not binding on Tribunals, although both state that where a Tribunal decides to depart from the guidance it should explain the reason for the departure.⁶
- 1.9 There was attached to the Review Panel’s Call for Submissions of May 2017, and is annexed as the Appendix hereto, a snapshot of the source of the FRC’s jurisdiction in respect of the above procedures, their scope, and the list of sanctions that can be imposed under them.

Methodology

- 1.10 To undertake its task, the Review Panel held a series of introductory meetings with a range of persons from, or associated with, the FRC, which served the following purposes:
 - (a) to develop an understanding of the reasons for the Review being commissioned by the FRC, the FRC’s roles and responsibilities and the relevant underlying legislation and regulatory procedures; and
 - (b) to allow, at their request, the large accountancy firms to meet with the Review Panel to gain an understanding of the Review and ask questions in this regard.
- 1.11 Next, the Review Panel issued a call for submissions (the “Call for Submissions”) which was published on the FRC’s website. In order to obtain material from a full range of viewpoints, the Review Panel issued specific invitations to a wide range of stakeholders to respond to the Call for Submissions and asked for views in respect of any person or body whom respondents thought the Review Panel should contact for assistance in relation to the matters raised by the review. The stakeholders to whom specific invitations were sent included:
 - (a) firms regulated by the FRC;
 - (b) the professional bodies participating in the FRC’s disciplinary schemes;

⁵ Authorities on the meaning of “misconduct” and similar terms were considered in *R (oao Baker Tilly UK Audit LLP & Ors) v FRC & Ors* [2015] EWHC 1398 (Admin). It is more important, however, to apply the wording of the definition rather than rely on what has been said about “misconduct” (undefined) or similar but not identical terms in different contexts.

⁶ See e.g. paragraph 5 of the Sanctions Guidance.

- (c) investors and their representative bodies;
- (d) journalists;
- (e) politicians;
- (f) senior members of the judiciary;
- (g) other regulators;
- (h) law firms with experience of representing respondents in FRC cases;
- (i) other miscellaneous entities with relevant expertise or an interest in the work of the FRC and the cases considered for action under the FRC's enforcement procedures.

1.12 For comparative analysis purposes, the Review Panel also sought information from other members of the International Forum of Independent Audit Regulators Enforcement Working Group⁷ and members of the Committee of European Audit Oversight Bodies⁸ in respect of:

- (a) the range and nature of sanctions available in respect of registered audit/accountancy individuals and firms;
- (b) any applicable principles/objectives that sanctions are designed to meet;
- (c) any guidance/policies relied on by decision-makers when determining sanctions;
- (d) whether financial penalties can be imposed by those regulators, and if so, what the starting point is in respect of determining such penalties (such as firm revenue, profit or audit fee);
- (e) the record financial penalty imposed by those regulators and the nature of the matter giving rise to the financial penalty; and
- (f) the range of sanctions determined by those regulators over the last five to ten years.

1.13 Similar information was sought from other regulators in the UK including the Financial Conduct Authority, ("FCA"), the Prudential Regulation Authority, ("PRA") the Pensions Regulator, ("TPR"), Ofgem and the Civil Aviation Authority.

1.14 The Review Panel considered sanctions guidance published by a range of other regulators in the UK and the underlying principles applicable to regulatory sanctions regimes and reviewed decisions made under the FRC's disciplinary schemes by FRC Tribunals.

1.15 The Review Panel is very grateful for the submissions received, many of which have been of high quality. It notes that the bulk of submissions from accountancy firms

⁷ Membership detailed at: <https://www.ifiar.org/enforcement-working-group/>

⁸ Composition detailed at: https://ec.europa.eu/info/sites/info/files/ceaob-composition_en_1.pdf

concerned audit related matters, and it is understandable that this was their focus. However, the Accountancy Scheme will in future, be predominantly concerned with non-audit matters⁹ and the Actuarial Scheme will continue as now and, therefore, the Sanctions Guidance and Actuarial Scheme Sanctions Guidance need to remain fit for purpose.

- 1.16 A substantial part of the submissions concentrated on financial sanctions. As will become apparent - see section 8 below - in our view, whilst financial sanction is important, greater attention needs to be paid in the future to the use of non-financial sanctions than has been the case in the past.

⁹ Albeit that there is a run-off of statutory audit cases to be concluded under the Accountancy Scheme and cases relating to local audit matters and Crown Dependency recognised auditors matters will continue to fall to be dealt with under the Accountancy Scheme.

2. Objectives of the FRC's enforcement procedures in relation to sanctions

2.1 The objectives set out in paragraph 9 of the Sanctions Guidance are as follows:

“ ...

- *to deter members of the accountancy profession from committing 'Misconduct';*
- *to protect the public from Members and Member Firms whose conduct has fallen significantly short of the standards reasonably to be expected of that Member or Member Firm;*
- *to maintain and promote public and market confidence in the accountancy profession and the quality of corporate reporting; and*
- *to declare and uphold proper standards of conduct amongst Members and Member Firms.*

The primary purpose of imposing sanctions for acts of Misconduct is not to punish, but to protect the public and the wider public interest. Therefore a Tribunal's objective should be to impose the sanction or combination of sanctions necessary to achieve the objectives of the Scheme.”

2.2 The Sanctions Guidance is expressed in paragraph 10 to have been developed to help Tribunals achieve these objectives by imposing sanctions which:

- “• *improve the behaviour of the Member or Member Firm concerned;*
- *are tailored to the facts of the particular case and take into account the nature of the Misconduct and the circumstances of the Member or Member Firm concerned;*
- *are proportionate to the nature of the Misconduct and the harm or potential harm caused;*
- *eliminate any financial gain or benefit derived as a result of the Misconduct; and*
- *deter Misconduct by the Member, Member Firm or others.”*

2.3 The objectives of the AEP in relation to sanctions are encapsulated in paragraphs 11 and 12 of the Sanctions Policy as follows:

“11. In determining the appropriate sanction, a Decision Maker should have regard to the reasons for imposing sanctions for a breach of the Relevant Requirements in the context of the Audit Enforcement Procedure. Sanctions are imposed to achieve a number of purposes, namely:

- a) *to deter Statutory Auditors and Statutory Audit Firms from breaching the Relevant Requirements relating to statutory audit;*

- b) *to protect the public from Statutory Auditors and Statutory Audit Firms whose conduct has fallen short of the Relevant Requirements;*
- c) *to maintain and promote public and market confidence in Statutory Auditors and Statutory Audit Firms and the quality of their audits;*
- d) *to declare and uphold proper standards of conduct amongst Statutory Auditors and Statutory Audit Firms.*

12. *The primary purpose of imposing sanctions for breaches of the Relevant Requirements is not to punish but to protect the public and the wider public interest. Therefore, a Decision Maker's objective should be to impose the sanction or combination of sanctions necessary to achieve the objectives set out above."*

2.4 The Sanctions Policy contains similar provisions, *mutatis mutandis*, to those contained in paragraph 10 of the Sanctions Guidance.

2.5 There was broad (but not universal) agreement by respondents to the Call for Submissions that these objectives are satisfactory. We take the same view of the objectives, and, also, of the function of sanctions stated in paragraph 10 of the Sanctions Guidance, subject to the following considerations.

2.6 First, it seems to us that the objectives are expressed in the wrong order. Accountants, actuaries, and auditors in particular, perform a vital and important function for the benefit of the public and individual members of it. In the case of audits, the audit may be the only independent check on the behaviour of directors or senior management of a company, who may have every reason to overstate profits and understate losses and liabilities. Serious failings in auditing may cause or risk large losses to companies, investors and counterparties. It is, therefore, very much in the public interest that there should be a regime which declares and upholds proper standards. The FRC needs to promote public confidence that the profession will follow those standards and protection for the public from those who do not. This it does by enforcing compliance with the proper standards which it sets. In order to do that it needs to administer sanctions which, *inter alia*, deter those who have departed, or may depart, from those standards.

2.7. The statement of objectives should follow this order, particularly since deterrence could be regarded as a subsidiary objective whose function is to help secure the earlier ones. As Lord Collins put it in *R (on the application of Coke-Wallis) v ICAEW* [2011] UKSC 1:

"60 ...The primary purpose of professional disciplinary proceedings is not to punish, but to protect the public, to maintain public confidence in the integrity of the profession, and to uphold proper standards of behaviour: see e.g. Bolton v Law Society [1994] 1 WLR 512, 518, per Sir Thomas Bingham MR; Gupta v General Medical Council [2002] 1 WLR 1691, para 21, per Lord Rodger."

2.8 Second, we think it appropriate to include, as a stated purpose in respect of the AEP, the maintenance and enhancement of the quality and reliability of future audits (as is

specified by the US Public Company Accounting and Oversight Board (“PCAOB”)¹⁰ and public confidence in the regulation of the accountancy profession.

Recommendation 1

We regard it as more appropriate to express the purposes of sanctions as including (for paragraph 9 of the Sanctions Guidance¹¹):

- “• *to declare and uphold proper standards of conduct amongst Members and Member Firms **and to maintain and enhance the quality and reliability of accountancy work;***
- *to maintain and promote public and market confidence in the accountancy profession and the quality of corporate reporting **and in the regulation of the accountancy profession;***
- *to protect the public from Members and Member Firms whose conduct has fallen significantly short of the standards reasonably to be expected of that Member or Member Firm; and*
- *to deter members of the accountancy profession from committing Misconduct.”*

and as including (for paragraph 11 of the Sanctions Policy):

- “a) *to declare and uphold proper standards of conduct amongst Statutory Auditors and Statutory Audit Firms **and to maintain and enhance the quality and reliability of future audits;***
- b) *to maintain and promote public and market confidence in Statutory Auditors and Statutory Audit Firms and the quality of their audits **and in the regulation of the accountancy profession;***
- c) *to protect the public from Statutory Auditors and Statutory Audit Firms whose conduct has fallen short of the Relevant Requirements;*
- d) *to deter Statutory Auditors and Statutory Audit Firms from breaching the Relevant Requirements relating to statutory audit.”*

2.9 We do not regard this proposal as mere sequential tinkering. It reflects the basic aim of upholding proper standards and maintaining public confidence that they will be observed, and what we take to be the principal rationale for a sanctions regime, namely the protection of the public - rightly described in *GMC v Jagjivan* [2017] EWHC 1247 (Admin), 40(vii) as the overarching concern of the professional regulator. It also meets the point raised by some respondents to the Call for Submissions;

¹⁰ <https://pcaobus.org/Enforcement/Documents/Release2003-015.pdf>

¹¹ With equivalent amendments made to the Actuarial Scheme Sanctions Guidance.

- (a) that a scheme whose primary purpose is not to punish but to protect the public should not begin its statement of purposes with deterrence; and
- (b) that doing so may cause disproportionate weight to be given to deterrence as opposed to other factors (such as remediation).

2.10 That leads us to two further questions.

Punishment as an objective

2.11 The first question is this. Since one of the purposes of the Sanctions Guidance and the Sanctions Policy is to deter, and nothing is likely to deter if it does not involve at least some form of punishment, why should punishment itself not be one of the stated purposes?

2.12 We do not think that punishment, of itself, is an appropriate objective for these regimes. A sanction which amounts to punishment or contains a punitive element may well be necessary in order to uphold proper standards, maintain public confidence and deter repetition. For that reason, we would not think it right to remove all reference to punishment. Any such sanction needs to be proportionate to the gravity of the breach (such that, in very bad cases, it may be very severe) and will, in proportion to its size, mark by public stigma the seriousness of the breach, make clear to the profession and others the unacceptability of the conduct in question, and, by showing what may happen if it is repeated, deter recurrence. The purposes already specified in the Sanctions Guidance and the Sanctions Policy provide adequate justification for appropriate punishment.

2.13 We are reinforced in that view by the fact that most disciplinary schemes do not have punishment as an objective *in itself*, although some refer to “penalties”. For example, TPR’s policy on the imposition of financial penalties pursuant to section 10 of the *Pensions Act 1995*¹² says that:

“Our underlying objective is to promote compliance with pensions legislation. Penalties punish wrongdoing, deter repetition and act as a warning to others.”

2.14 Many regulators consider that punishing or “penalising” is subsidiary to the principal objective or a consequence of it. Some indicate, expressly, that punishment is not an objective. Thus, paragraph 16 of the *Sanctions Guidance for members of medical practitioners tribunals and for the General Medical Council’s decision makers*¹³ says:

“Sanctions are not imposed to punish or discipline doctors, but they may have a punitive effect.”

¹² [TPR’s Monetary penalties policy](#)

¹³ [Sanctions Guidance for members of medical practitioners tribunals and for the General Medical Council’s decision makers](#)

Section B of the *Indicative Sanctions Guidance Note* by the IFoA¹⁴ (the “IFoA Indicative Sanctions Guidance”) has a sentence to the same effect.¹⁵

Inadvertent wrongdoing

- 2.15 The second question is whether a sanction such as a financial penalty should be used in cases where the wrongdoing was unintentional or consisted of what some respondents described as “*inadvertent error*”. There was general agreement by respondents to the Call for Submissions that where an accountant/auditor had been guilty of dishonesty, deliberate flouting of the rules or recklessness¹⁶ (all of which may involve a criminal offence by an auditor under section 507 of the *Companies Act 2006*), severe sanctions were likely to be appropriate. By contrast many failings are in no way dishonest or intentional but inadvertent or unintentional. In such cases, it is said, a financial penalty (or suspension) is in no real sense a deterrent. The individual concerned was not aware that what he/she was doing was wrong¹⁷. So, he will not have been deterred from error by the knowledge that others have been fined in the past and that he or his firm might be in the future. Nor will he or his firm have made any financial benefit from his error. More likely the reverse. Further, in several audit cases, the directors or senior management of a company may have misled, *inter alios*, the auditors, whose fault is, simply, not to have shown a sufficient degree of professional scepticism. In any event an increase in financial penalties would have no effect on the incidence of misconduct/breach that bore any proportion to the incremental effect of deterring wrongdoing.
- 2.16 We accept that there is a distinct division between cases involving fraud, dishonesty, deliberate error or recklessness on the one hand and those which have none of those characteristics. Cases in the former category are likely to attract exclusion in the case of an individual and should receive a distinctly larger financial penalty than that which might be imposed in other cases. We consider this further at paragraph 8.3, and paragraph 5.31 respectively, below.
- 2.17 But we do not accept that cases can be divided into those in the former category, where condign punishment may be appropriate, and cases of lack of intention or “inadvertence” where financial penalties, let alone suspension, will, or may well, not be appropriate at all. The spectrum of failings which may amount to regulatory breach is very wide, as is the range of sanction from reprimand to exclusion. An individual auditor can be grossly incompetent and his firm’s procedures unacceptably lax with disastrous consequences without anyone being either dishonest or reckless or guilty of

¹⁴ [IFoA Indicative Sanctions Guidance](#)

¹⁵ The emphasis of the FCA’s enforcement has been on “*credible deterrence*”. When increasing penalties in 2009 its predecessor body, the Financial Services Authority, said that “*the primary purpose of imposing a financial penalty is to deter*”. However, section 6.5.3 of the FCA’s Decision Procedure and Penalties Manual states that the FCA’s penalty setting regime is based on disgorgement, discipline and deterrence. “*Discipline*” means that a firm or individual should be penalised for wrongdoing [DEPP Manual](#). Another variant is the Environment Agency’s “*punish and /or deter*”.

¹⁶ Of which there are examples in cases brought by the FRC: see the cases of [The Accountancy and Actuarial Discipline Board and Ian Matthew Storey](#) and [The Executive Counsel to the FRC and Diane Jarvis](#) where the sanctions were for exclusion for a recommended period of 8 and 10 years respectively. In the former case the Tribunal said, at paragraph 26, that the case was not presented to them as a case of dishonesty but said that it was a serious case of the deliberate telling of untruths, improper manipulations, false assurances and reliance on documents which were highly misleading; which sounds as close to dishonest as it is possible to be.

¹⁷ Hereafter words denoting the masculine gender include the feminine.

intentionally doing what was known to be wrong. In cases under the Accountancy Scheme, that which is to be the subject of sanction will by definition have involved an important issue affecting the public interest and misconduct which *falls significantly short of the standards reasonably to be expected* of a Member or Member Firm or *has brought, or is likely to bring, discredit* to the Member or the Member Firm or to the accountancy profession. Many cases brought under the AEP are likely to involve what would have amounted to Misconduct under the Accountancy Scheme. For such failings unintentional oversight or inadvertence is likely to be an inadequate summary.

- 2.18 We do not accept that in cases where actions have not been dishonest or deliberate, the deterrent effect of financial sanctions is either irrelevant in principle, or non-existent in practice. Further, absence of dishonesty does not mean that a substantial financial penalty may not be needed to mark the seriousness and significance of the wrongdoing, and the disapprobation which it merits, with a view, also, to ensuring that the individual or firm concerned, and others, pay more attention to what is required in the future. The prospect of significant financial penalties for errors, and of reprimands, or worse, is likely to be one of the factors that encourage investment in improved training and review/compliance procedures and will contribute to enhanced diligence.¹⁸ In addition, maintenance of public confidence in the profession depends in part on the knowledge that those who are guilty of serious failings will be dealt with in an appropriate fashion which may involve a significant penalty.

Relevant case law

- 2.19 In reaching our conclusions we have borne in mind the case law on this subject. In *Bolton v Law Society* [1994] 1 WLR 512 a solicitor had not been dishonest but “*naïve and foolish*” in his handling of £45,000 received from a building society which he had wrongly disbursed in anticipation of completion. His clients were the seller, who was his wife; the buyer (who reneged), who was his brother-in-law; and the building society. When, upon investigation by the Solicitors Complaints Bureau, what he had done was revealed, the solicitor repaid the principal sum. He was later sued by the building society for the interest lost and he satisfied the judgment obtained. The Solicitors Disciplinary Tribunal suspended him for two years. The Divisional Court, which heard new evidence of his good character, held that suspension was disproportionate. The Court of Appeal held that it would require a very strong case to interfere with the Tribunal’s order and would have restored the order of the Tribunal; but, having regard to the lapse of time since the Tribunal’s order, which had been stayed, declined to restore it because it would, in the circumstances, be oppressive to reinstate the order for suspension.

- 2.20 In the course of his judgment Lord Bingham observed:

“*15 It is important that there should be full understanding of the reasons why the Tribunal makes orders which might otherwise seem harsh. There is, in some of these orders, a punitive element: a penalty may be visited on a solicitor who has fallen below the standards required of his profession in order to punish him for what he has done and to deter any other solicitor*

¹⁸ As one respondent put it “*the prospect of an individual’s career and established reputation being irrevocably damaged is a highly significant deterrent.*” Similar considerations apply in respect of the reputational damage to firms arising from findings of wrongdoing and consequent sanction.

tempted to behave in the same way. Those are traditional objects of punishment. But often the order is not punitive in intention. Particularly is this so where a criminal penalty has been imposed and satisfied. The solicitor has paid his debt to society. There is no need, and it would be unjust, to punish him again. **In most cases the order of the Tribunal will be primarily directed to one or other or both of two other purposes.** One is to be sure that the offender does not have the opportunity to repeat the offence. This purpose is achieved for a limited period by an order of suspension; plainly it is hoped that experience of suspension will make the offender meticulous in his future compliance with the required standards. The purpose is achieved for a longer period, and quite possibly indefinitely, by an order of striking off. **The second purpose is the most fundamental of all: to maintain the reputation of the solicitors' profession as one in which every member, of whatever standing, may be trusted to the ends of the earth.** To maintain this reputation and sustain public confidence in the integrity of the profession it is often necessary that those guilty of serious lapses are not only expelled but denied re-admission. If a member of the public sells his house, very often his largest asset, and entrusts the proceeds to his solicitor, pending re-investment in another house, he is ordinarily entitled to expect that the solicitor will be a person whose trustworthiness is not, and never has been, seriously in question. Otherwise, the whole profession, and the public as a whole, is injured. A profession's most valuable asset is its collective reputation and the confidence which that inspires.

- 16** *Because orders made by the Tribunal are not primarily punitive, it follows that considerations which would ordinarily weigh in mitigation of punishment have less effect on the exercise of this jurisdiction than on the ordinary run of sentences imposed in criminal cases. It often happens that a solicitor appearing before the Tribunal can adduce a wealth of glowing tributes from his professional brethren. He can often show that for him and his family the consequences of striking off or suspension would be little short of tragic. Often, he will say, convincingly, that he has learned his lesson and will not offend again. On applying for restoration after striking off, all these points may be made, and the former solicitor may also be able to point to real efforts made to re-establish himself and redeem his reputation. All these matters are relevant and should be considered. But none of them touches the essential issue, which is the need to maintain among members of the public a well-founded confidence that any solicitor whom they instruct will be a person of **unquestionable integrity, probity and trustworthiness.** Thus, it can never be an objection to an order of suspension in an appropriate case that the solicitor may be unable to re-establish his practice when the period of suspension is past. If that proves, or appears likely to be, so the consequence for the individual and his family may be deeply unfortunate and unintended. But it does not make suspension the wrong order if it is otherwise right. The reputation of the profession is more important than the fortunes of any individual member. Membership of a profession brings many benefits, but that is a part of the price."*

- 2.21 Whilst that case concerned the wrongful disbursement by a solicitor of clients' money, which is unlikely to be a feature of many cases under the Schemes and the AEP, and reflected the need to ensure that the public can repose absolute confidence in the trustworthiness of solicitors handling funds, it underscores the primary purposes of professional sanctions, the place of punishment as an element in (rather than a primary purpose of) sanctions policy, and the fact that membership of a profession comes at a price which involves the risk of sanction.
- 2.22 The reasoning in *Bolton* has been adopted in other cases - see, for instance, *Fatnani & Anor v GMC* [2007] EWCA Civ 46 and *Gupta v GMC* [2002] 1 WLR 1691 which differentiate the function of a disciplinary panel in imposing sanctions from that of a court imposing retributive punishment.
- 2.23 The statements of principle contained in *Bolton* were held to be good law in *The Law Society v Salsbury* [2008] EWCA Civ 1285, where a number of earlier authorities on disciplinary cases were reviewed, subject, however, to the important qualification that the Tribunal must take into account the rights of the solicitor under Articles 6 and 8 of the *European Convention on Human Rights*, and that it is now an overstatement to say that “a very strong case” is required before the court will interfere with a decision of the Tribunal. If the Court, despite paying considerable respect to the decision of the sentencing tribunal, is satisfied that the sentencing decision was clearly inappropriate then it will intervene.

Audit quality

- 2.24 Specifically in relation to audit, we recognise that the role of sanctions in promoting good behaviour is a limited one and that there are other significant promoters of good quality audit work. These include a range of tasks carried out by the FRC as competent authority or delegated to the recognised supervisory bodies including continuing education and training, standard setting and monitoring activity.¹⁹ Monitoring activity by the FRC Audit Quality Review (“AQR”) team assesses the current quality of the firm's work and gives the market a measure of it. Firms and individuals aspire to achieve a good audit quality category, since Audit Committees will scrutinise such reviews in deciding whom to engage, and will seek to respond to weaknesses revealed. From the standpoint of the profession the factors include the investment made by firms in improvements in audit quality and training, the promotion by firms and individuals of professional ethics and core values, and investors' relationships with firms. We also recognise that the publication of findings of Misconduct/breaches of a Relevant Requirement and the resulting sanction may weigh more heavily with firms and individuals than the financial penalty, and that an increase in financial penalties does not *pro rata* increase deterrence.

Human Rights Act 1998 and proportionality

- 2.25 Some respondents to the Call for Submissions suggested that there should be explicit reference to the *Human Rights Act 1998* (“HRA”) and that an objective should be to impose the fair and proportionate sanction or combination of sanctions necessary to achieve the objectives of the Schemes/AEP. We see no need for either. The FRC is plainly subject to the HRA. We do not regard the Sanctions Guidance or the Sanctions

¹⁹ These tasks are set out in regulation 3(1) of SATCAR.

Policy as inconsistent with the HRA or that explicit reference to it will afford any assistance. The need for fairness and proportionality is already spelt out in the Sanctions Guidance (paragraph 6) and the Sanctions Policy (for example, paragraphs 5 and 10).

3. The approach to be taken when determining sanctions under the Sanctions Guidance and the Sanctions Policy

3.1 The existing Sanctions Guidance and the Sanctions Policy contains extensive provision as to the approach that should be taken to the application of sanctions. A number of points of criticism were made by respondents to the Call for Submissions in respect of their content and application. Several respondents submitted that, notwithstanding the size of the material in the Sanctions Guidance and the Sanctions Policy, it provides insufficient practical help to enable those affected to assess what level of penalty they should expect for what conduct and why. Particular criticisms include the absence of reference in the guidance to the need for a “bottom up approach”, and the absence of any form of tariff or guidelines. As another respondent put it, “*A reader of the Sanctions Guidance and the Sanctions Policy would be unable to determine whether the appropriate fine in a given set of circumstances should be £100,000 or £100 million.*” Further, decisions of Tribunals, which were few and far between, did not, it was said, give sufficient explanation as to why a particular figure had been chosen, and the reasoning behind agreed settlements was not apparent.

3.2 Paragraph 16 of the Sanctions Guidance provides that the normal approach to determining the sanction to be imposed in a particular case should be to:

- “i. Assess the nature and seriousness of the Misconduct found by the Tribunal (paragraphs 17 to 21);*
- ii. Identify the sanction (including the range within which any fine might fall) or combination of sanctions that the Tribunal considers potentially appropriate having regard to the Misconduct identified in i above (paragraphs 22 to 47);*
- iii. Consider any relevant aggravating or mitigating circumstances and how those circumstances affect the level of sanction under consideration (paragraphs 48 to 54);*
- iv. Consider any further adjustment necessary to achieve the appropriate deterrent effect (paragraphs 55 and 56);*
- v. Consider whether a discount for admissions or settlement is appropriate (paragraphs 57 to 61);*
- vi. Decide which sanction(s) to order and the level/duration of the sanction(s) where appropriate; and*
- vii. Give an explanation at each of the six stages above, sufficient to enable the parties and the public to understand the Tribunal’s conclusions.”*

Paragraph 19 of the Sanctions Policy is to the same effect.

3.3 We do not regard any of sub-paragraphs 16(i) – (vi), or their Sanctions Policy equivalent, as inapposite and they provide a useful framework for Settlement Agreements. But the combination of the six-step process in (i) – (vi) and the stage by stage explanation required by (vii) seems to us unduly formulaic and appears to require

Tribunals and other decision makers to adopt a format which is unduly restrictive. It is important, indeed vital, that decision makers should give sufficient reasons to enable those concerned to know, (a) what they have concluded on the matters in paragraph 16(i) - (vi), and, equally importantly, (b) why they have reached their conclusions. But, provided that they do so, it need not be obligatory to follow any given format or order, and decisions should not be open to attack on the ground of a failure to do so. Nor do we regard it as appropriate to require decision makers not only to decide what financial penalty (if any) to impose, but, also, to specify a range within which their proposed financial penalty might fall. To do so may be helpful but should not be mandatory.

Recommendation 2

We recommend that the Sanctions Guidance should stipulate that the normal approach should involve a consideration of the matters at paragraph 16(i) – (vi) and that Tribunals should ensure that their decisions give reasons which indicate what view they have reached on these matters and why; but that paragraph 16(vii) should be omitted, as should the obligation in paragraph 16(ii) to identify a range in which any fine might fall. Equivalent amendments should be made in respect of the approach to be taken by AEP decision makers.

Assessing the nature and seriousness of the wrongdoing

- 3.4 Paragraph 18 of the Sanctions Guidance contains a list of 17 factors which may be considered. All of these seem to us potentially relevant and to provide a useful check list by reference to which to determine sanctions. We see no need to exclude or change any of them; nor was that suggested to us.
- 3.5 Paragraph 21 of the Sanctions Policy contains a list of 22 factors, many of which are in very similar terms to those that appear in paragraph 18 of the Sanctions Guidance or elsewhere therein. There are, however, some factors which appear in paragraph 21 of the Sanctions Policy which are not in the Sanctions Guidance and ought, in our view to be there. They, and the relevant sub-paragraphs in the Sanctions Policy, are the following:
- (a) *the gravity and duration of the Misconduct; (b)*
 - (b) *whether the Misconduct was isolated, or repeated or ongoing; (j)*
 - (c) *if repeated or ongoing, the length of time over which the breaches occurred; (k)*
 - (d) *whether steps had been taken to address any similar Misconduct previously identified: (m)*
 - (e) *whether the Member or Member Firm has failed to comply with any previous conditions; (o)*
 - (f) *whether it is likely that the same type of Misconduct will recur; (p)*
- 3.6 The items listed above use phraseology suitable for the Sanctions Guidance by referring to Misconduct rather than breach of Relevant Requirements.

Recommendation 3

We recommend that the matters listed at paragraph 21(b), (j), (k), (m), (o) and (p) should be included in paragraph 18 of the Sanctions Guidance.

- 3.7 Paragraph 21(e) of the Sanctions Policy – the financial strength of the Statutory Auditor or Statutory Audit Firm; and paragraph 21(f) – the level of cooperation of the Statutory Auditor or Statutory Audit Firm with the competent authority are reflected in paragraphs 32 and 34 and 53 and 54 of the Sanctions Guidance. The latter two paragraphs do not however refer expressly to the level of cooperation and, in our view, paragraph 18 of the Sanctions Guidance should do so.
- 3.8 There are two further matters which do not appear in either the Sanctions Guidance or the Sanctions Policy which we think should be included namely;
- (a) the impact on the Member or the Member Firm [Statutory Auditor or the Statutory Audit Firm] of their involvement in the investigation and the disciplinary proceedings; and
 - (b) what remedial actions have been taken by the Member or Member Firm [Statutory Auditor or Statutory Audit Firm] concerned.

Recommendation 4

We recommend that paragraph 18 of the Sanctions Guidance should include:

“The level of cooperation of the Member or Member Firm with the FRC, or another appropriate regulatory, disciplinary or enforcement authority.”

We recommend that the Sanctions Guidance and the Sanctions Policy should include the following:

“the impact on the Member or the Member Firm [Statutory Auditor or the Statutory Audit Firm] of their involvement in the investigation and the disciplinary proceedings;

what remedial actions have been taken by the Member or Member Firm [Statutory Auditor or Statutory Audit Firm] concerned.”

Aggravating factors

- 3.9 Paragraph 53 of the Sanctions Guidance and paragraph 63(j) of the Sanctions Policy provide that one of the matters that can be taken into account as an aggravating factor is that:

“the Member or Member Firm [Statutory Auditor or Statutory Audit Firm] has a poor disciplinary record (for example, where an adverse finding has previously been handed down against the Member or Member (sic) [Statutory Auditor or Statutory Audit Firm] by the FRC or another disciplinary or regulatory body). The

more serious and/or similar the previous Misconduct or breach, [previous breaches] the greater the aggravating factor;”

In our view the Sanctions Guidance and the Sanctions Policy should make it clear that a previous sanction is not automatically going to produce an increased penalty and that much depends on the circumstances.

Recommendation 5

We recommend that paragraph 53 of the Sanctions Guidance and paragraph 63(j) of the Sanctions Policy be revised as follows:

*“the Member or Member Firm [Statutory Auditor or Statutory Audit Firm] has a poor disciplinary record (for example, where an adverse finding has previously been handed down against the Member or Member by the FRC or another disciplinary or regulatory body). The more serious and/or similar the previous Misconduct or breach [previous breaches], the greater the aggravating factor. **The fact that a Sanction has previously been imposed will not automatically be regarded as a significant aggravating factor. Much will depend on the degree of similarity, the time that has elapsed since the earlier sanction was imposed, the changes that have taken place since then, and the response (or lack of it) to any previous finding. Account should be taken of the current record of the quality of the work of the Member or Member Firm [Statutory Auditor or Statutory Audit Firm].**”*

The bottom up approach

- 3.10 The reference to a “bottom up” approach is to the principle that a tribunal or other decision maker should impose the lowest penalty that is needed in the circumstances of the case. Some regulatory regimes make express reference to this. Thus, the *Good decision making: fitness to practise hearings and sanctions guidance* of the General Pharmaceutical Council²⁰ states at paragraph 5.1:

“When making its decision,...the committee should consider the full range of sanctions it can impose. It should use its discretion and decide on a sanction that is appropriate and proportionate. By ‘proportionate’, we mean that a sanction should be no more serious than it needs to be to achieve its aims”;

and makes reference to case law in this regard: *Chaudhury v General Medical Council* [2002] UKPC 41. Then in relation to the ‘bottom up’ approach at paragraph 5.3 the guidance states:

“To make sure that the sanction is proportionate, the committee should consider each available sanction, starting at the lowest, and decide if it is appropriate to the case. If it is not, the committee should consider the next sanction, and so on, until it decides that a particular sanction is appropriate”;

and again refers to case law: *Giele v General Medical Council* [2005] EWHC 2143 (Admin).

²⁰ [Good decision making: Fitness to practise hearings and sanctions guidance](#)

- 3.11 In the latter case above, the judge quashed a decision of the GMC to erase the doctor from the register, and substituted a 12 month suspension. He did so because the Panel had approached the question of sanction in the wrong way clearly believing, in the light of erroneous advice from its legal assessor, that, for a case of the relevant type, (sexual activity with a patient), erasure should be ordered unless exceptional circumstances existed.
- 3.12 We are not convinced that the Sanctions Guidance/Sanctions Policy needs amending in this respect. The current Sanctions Guidance and the Sanctions Policy provide (at paragraphs 12 and 15 respectively) express guidance in respect of the principle of proportionality and state, that in assessing proportionality, a Tribunal should consider whether a particular sanction is commensurate with the circumstances of the case, including the seriousness of the Misconduct/breach of the Relevant Requirements found and the circumstances of the Member or Member Firm/Statutory Auditor or Statutory Auditor concerned. A sanction that exceeds what is necessary is by definition disproportionate. A sanction or combination of sanctions that is proportionate will be that which is no higher than is required to meet the objectives of the Schemes/the AEP and is commensurate with the seriousness of the case. We do not think it likely that any FRC Tribunal or other decision maker will commit the sort of error which led to the appeal in *Giele* and are not aware that there has been any confusion in any of the FRC cases or challenge based on such an error.
- 3.13 In addition, the sanctions available cannot be viewed as an entirely linear progression, starting, for example, with reprimand and ending with exclusion, or withdrawal of registration or authorisation or licence in the case of a Member Firm. The appropriate sanction may be, for instance, a combination of suspension, fine, and a requirement of further training.

4. Tariffs and guidelines

- 4.1. One of the matters which we were asked to consider was whether, having regard to fairness, the financial sanctions should be strengthened by the inclusion of a tariff. A number of respondents to the Call for Submissions submitted that it would be of assistance to all concerned if the Sanctions Guidance/Sanctions Policy contained some form of tariff of penalties, possibly along the lines of those of the ICAEW; or guidelines or at least a range of penalties, perhaps along the lines of those provided by the FCA or in Sentencing Guidelines provided by the Sentencing Guidelines Council (“SGC”). However, one respondent recognised that to develop a detailed tariff would be “challenging”.
- 4.2 We sympathise with this suggestion and have carefully considered whether it is one that we should recommend. We have decided not to do so. Our reasons for taking this view are these. In relation to both audit and non-audit related breaches, the range of failings which may constitute Misconduct under the Schemes, or a breach of Relevant Requirements covered by the AEP, is very wide. In determining whether an individual or a firm has committed Misconduct/a breach of the Relevant Requirements, and, if so, what sanction to impose, decision makers are likely to have to consider a wide range of wrongdoing and of facts, factors, and circumstances which, or the combination of which, may differ widely from case to case. We do not think it possible to create a useful tariff or guideline system, which does not either unduly fetter the discretion of tribunals or which, itself, provides a flexibility which then brings back into play the application of the principles specified in the existing guidance. Such a system:
- (a) would not be able to cater for every, or even most, eventualities;
 - (b) might result in an unduly restrictive approach with regard to the seriousness of wrongdoing;
 - (c) runs the risk that a sanction or combination of sanctions is disproportionate (in either direction) or otherwise does not meet the objectives they are designed to achieve.²¹ It also runs the risk of undue concentration on financial penalties and of obscuring the fact that punishment *per se* is not an objective of the Sanctions Guidance/Sanctions Policy (and as we have concluded, nor should it be).

The ICAEW Model

- 4.3 The ICAEW *Guidance on Sanctions*²² (the “ICAEW Guidance”) provides for a tariff with a range of relatively low financial penalties for a series of individual failings, and these figures can be used in future cases for failings in the same category. Thus for “*Audit work of a seriously defective nature*”, the ICAEW Guidance stipulates the following starting points;

“Firm

²¹ To take a single example: a starting point or range that specified x% or x% - y% of revenue, or audit revenue, might be appropriate for a medium sized firm but far too high for one of the Big 4.

²² [ICAEW Guidance on Sanctions](#)

Severe reprimand and a financial penalty equal to 1.5 audit fee. Adjust upwards if audit fee inadequate or if company subsequently collapsed.

RI/second review partner

*Exclusion and a financial penalty of £ 5,750 - £ 11,500.*²³

- 4.4 This a pretty modest penalty, even for a starting point. If, as happens, a firm cuts down on expenditure which contributes to audit quality, in order to charge lower fees and be more competitive, as a result of which an audit is seriously defective, a fine fixed on this basis is likely to be seriously inadequate. Another feature of a very low starting point is that it provides no real guidance in many cases.
- 4.5 We do not think it is feasible usefully to categorise the sort of failings covered by the Schemes or the AEP in a tariff or that to do so will provide effective assistance in the determination of appropriate sanctions.

The FCA Model

- 4.6 The FCA Decision Procedure and Penalties Manual (“DEPP Manual”) provides a very detailed step by step approach to the determination of financial penalty. The amount payable is to consist of two elements: first, disgorgement of the benefit received as a result of the breach and second, a financial penalty reflecting the seriousness of the breach. Those elements are incorporated in a five-step framework²⁴ involving:
- (a) the removal of any financial benefit derived directly from the breach;
 - (b) the determination of a figure which reflects the seriousness of the breach;
 - (c) an adjustment to (b) to take account of any aggravating and mitigating circumstances;
 - (d) an upward adjustment to the amount arrived at after (b) and (c), where appropriate, to ensure that the penalty has an appropriate deterrent effect; and
 - (e) if applicable, a settlement discount.
- 4.7 Under (b) the FCA may take a percentage of the firm’s revenue from the relevant product or business areas where that revenue is indicative of the harm or potential harm the breach may cause. The percentage taken then varies according to which level out of five, reflects the seriousness of the breach. Level 1 is 0% and Level 5 is 20%.²⁵ The PRA has a similar system, set out in *The PRA's approach to enforcement: statutory statements of policy and procedure*²⁶ but there is a discretion to determine an appropriate percentage.²⁷
- 4.8 We are not convinced that that approach should be adopted either. For the most part the above procedure reflects what is already contained in paragraphs 16 and 19 of the

²³ At page 15 of the ICAEW Guidance.

²⁴ At paragraph 6.5.3 of the DEPP Manual.

²⁵ At paragraph 6.5A.2 of the DEPP Manual.

²⁶ [The PRA's approach to enforcement: statutory statements of policy and procedure](#)

²⁷ At paragraphs 19 and 20.

Sanctions Guidance and the Sanctions Policy respectively. The most significant part is (b), the provisions of which are apt for many FCA cases, where the miscreant directly or indirectly benefits from the breach and where a proportion of its revenue may well be some form of measure of the harm caused or risked. We do not think that the range of circumstances with which the FRC enforcement procedures will be called upon to deal is one which can satisfactorily be covered by guidance such as this. Further the DEPP Manual itself states that the FCA recognises that a penalty must be proportionate to the breach and that it may decrease the level of penalty arrived at after applying the step at (b), if it considers that the penalty is disproportionately high for the breach concerned. So, in a sense, the end result is determined by what the FCA thinks to be proportionate to the breach.²⁸ That is sound in principle and the principle is reflected in the Sanctions Guideline and the Sanctions Policy.

The SGC Sentencing Guidelines model

4.9 Another model is to be found in the SGC Sentencing Guidelines. These often take the form of dividing criminal activity into bands of culpability and producing a range of penalties (usually terms of imprisonment) according to the harm caused or the intended consequences of the crimes committed. Thus, the Sentencing Guidelines in relation to corporate manslaughter, entitled *Health and Safety Offences, Corporate Manslaughter and Food Safety and Hygiene Offences Definitive Guideline*²⁹ prescribes for a large organisation (defined as having a turnover of over £50 million) the following for two different categories of offence - A, where, by reference to certain factors, there is a high level of culpability, and B, where there is a lower level:

“	<i>Starting point</i>	<i>Category range</i>
A	£7,500,000	£4,800,000 – £20,000,000
B	£5,000,000	£3,000,000 – £12,500,000” ³⁰

4.10 However, these guidelines deal with specific criminal offences, which are categories in themselves, and not a wide range of wrongdoing under a general heading of Misconduct or breach of Relevant Requirements.

Other possible models

4.11 It might be possible to produce a banding structure for audit or other failings in which different breaches were placed in a number of categories according to severity, and a different degree of sanction was attributed to breaches of the relevant severity, possibly with aggravating and mitigating factors applicable to each category. Alternatively, conduct could simply be described as having a high, medium or low level of culpability with a different range of sanctions for both. The range could differ according to the size of the firm. The Accountancy and Actuarial Discipline Board (“AADB”) put forward in its consultation on its proposed *Sanctions Guidance to Tribunals*³¹, (the “AADB Consultation Paper”) a proposal for five levels of misconduct which would

²⁸ At paragraph 6.5.3 of the DEPP Manual.

²⁹ [Health and Safety Offences, Corporate Manslaughter and Food Safety and Hygiene Offences Definitive Guideline](#)

³⁰ At page 24.

³¹ [AADB Sanctions Guidance to Tribunals: A consultation paper](#)

attract different ranges of percentages of annual turnover as a fine.³² An alternative suggestion was for tribunals to decide on a percentage of turnover which would represent the starting point for a fine which would then be increased upwards and downwards in the light of aggravating and mitigating factors.

- 4.12 In our view such an exercise would be a very difficult one to undertake and would not be likely to form a useful and appropriate aid to decision making. The relevant circumstances to which judgement has to be applied, the material considerations in determining an appropriate sanction, and the differences in size and scope of firms and individuals are, in our view, too multifarious to make this exercise worthwhile. We also bear in mind that the number of cases in which sanctions have heretofore been applied against individuals or firms under the Schemes is low in absolute terms (albeit constituting a steady flow) and very low relative to the total population to which the Schemes and the AEP apply.³³ Between 2009 and the present, investigations have resulted in sanctions being imposed on individuals 42 times and 18 times against firms. By contrast the FCA had some 151 outcomes in 2015/16 alone.³⁴
- 4.13 Since we take that view, we do not propose to analyse the proposed five levels of Misconduct or attempt some different categorisation. We would, however, observe that the draft definition of the different levels (which was criticised by many respondents to the AADB Consultation Paper) contained a number of characteristics, whereas the facts of any given case might well exhibit some but not all of the characteristics in several of the levels. In the event neither the five levels proposal nor the alternative was adopted and the present definition of “Misconduct” was introduced.
- 4.14 We are fortified in reaching this conclusion by the fact that the majority of responses from accountancy firms to the Call for Submissions did not favour the introduction of a tariff or banding system for a range of reasons. Nor did the Legal Chairs of the FRC’s Tribunal Panels, who regarded it as difficult, if at all possible, to give guidance like that of the SGC or the Criminal Division of the Court of Appeal, because of the difficulty of identifying paradigm cases. Many respondents emphasised that any tariff or guideline should not be prescriptive. We also note that the FRC Conduct Committee, following the consultation issued by the AADB, decided that the introduction of a formulaic approach would be inappropriate and did not adopt the proposals referred to in 4.11 above on the grounds that they would fetter the Tribunal’s discretion.³⁵ Further, the PCAOB told us that:

“The Board does not use prescriptive formulas or a tariff system when determining penalty amounts as each case presents unique facts. Moreover, it would be

³² See page 15 and page 31 (Appendix A) of the consultation document.

³³ We recognise that there have been stringent criticisms of the failure of the FRC to pursue enough investigations into allegations of misconduct (especially in relation to audit and accountancy wrongdoing in the run up to the financial crisis of 2008), of limitations on the scope of those investigations undertaken, and of limited investigative resources available to the FRC. The validity of those criticisms is outwith the scope of the Review. It is, however, obvious that inadequate or unduly dilatory investigation, investigation in respect of too short a period, and investigations begun too long after the event are inimical to the fulfilment of the objectives of the sanctions regime – see section 16 below.

³⁴ <https://www.fca.org.uk/enforcement-annual-performance-account-2015-16/14-enforcement-statistics>

³⁵ <https://frc.org.uk/about-the-frc/procedures-and-policies/enforcement-procedures/consultations-on-schemes-and-regulations>

impossible to predict the range of circumstances that may confront the Board in future cases.”

We agree with this approach.

Metrics

- 4.15 There was a considerable difference in the suggestions made to us as to the metrics that might be used for the determination of any fine against a firm in relation to incompetent audits, let alone the multiple or percentage thereof, if any, which should be applied to them. The suggestions included:
- (a) the audit fee in respect of the company audited or the profit therefrom;
 - (b) the total audit fees/profit in respect of all audits over the relevant period or all audits carried out by a particular unit of the firm;
 - (c) the total revenue received or profit secured over the relevant period from the firm’s relationship with the audited client.
- 4.16 In the particular circumstances of any given case, there may be something to be said for taking account of any one of these. The audit fee is the measure with the closest link to wrongdoing in the audit context, but total audit fees or total fees for a unit may be relevant if the failing in question had been a feature of all audits or all audits by that unit in the relevant year.³⁶ There will, also, be something to be said in opposition to each of these, since there is often no clear relationship between the wrongdoing and the metric suggested.
- 4.17. We do not think it appropriate to specify any default metric, as a measure of sanction: see, however paragraph 5.29.

³⁶ We recognise that business units which include audit work may not be limited to such work, in which case reference to the revenue of the unit may be inappropriate.

5. Fines/Financial Penalties

Guidance, relevant principles and highest fines imposed to date

5.1 The guidance on this topic provided in the Sanctions Guidance is contained in paragraphs 29-36. Paragraphs 41-51 of the Sanctions Policy are to the same effect. We regard it as sound, subject to the qualification that you will not find in it any clear start or ending point and to what we say in the next paragraph.

5.2 Paragraph 33 of the Sanctions Guidance and paragraphs 45-46 of the Sanctions Policy read:

*“In the majority of cases involving the imposition of a Fine on a Member Firm, **the amount of revenue generated by the firm or the business unit(s) involved in the Misconduct will be a factor** to be taken into account when assessing the size of Fine which would be necessary, in the circumstances of the particular case, to act as a credible deterrent. [Our emphasis]*

Where revenue is not an appropriate indicator of financial means, a Tribunal should seek an appropriate alternative measure. Other indicators of financial means include the level of profitability per partner, market share, the number of audit and non-audit clients and the respective size of those clients, the number of principals, partners and registered individuals.”

5.3 The revenue generated by the firm or the business unit involved is a factor insofar as it is an indicator of financial means. It is not, however, necessarily a sum of which a proportion should be taken as the measure of financial sanction. We do not understand the paragraph to be suggesting that it is.

5.4 The appropriate approach to fine/financial penalty³⁷ has to be considered in every case but few cases contain anything like a guideline. The most noticeable case which addressed questions of principle is *AADB v PwC re JP Morgan Securities Limited Client Money*³⁸ (the “PwC re JP Morgan case”). In that case, decided on 6 December 2011, PwC failed over 7 years to spot that JP Morgan Securities Limited (“JPMSL”) and JP Morgan Chase Bank had effected at the end of every day “sweeps” of the balance of segregated client assets into consolidated overnight interest-bearing accounts at the Bank with the result that client assets of JPMSL ceased temporarily to be segregated. The FCA had imposed on JPMSL a penalty of £33.32 million which was said to represent (after a discount of 30%) 1% of the average amount of the assets which had been allowed to remain desegregated. The FRC Tribunal rejected a submission that it should impose a financial penalty which related to the annual profits of PwC in the year ending 30 June 2010 at the same percentage as that which £33.32 million bore to the profits after tax of JPMSL in the year in which it was levied. That would have produced a fine of £44.3 million. The Tribunal also rejected the submission that the relative profits of the client and the auditor were relevant (PwC’s profits exceeded those of its client).

³⁷ The Schemes refer to fines, the AEP refers to financial penalties; we use the terms interchangeably.

³⁸ [AADB v PwC re JP Morgan Securities Limited Client Money](#)

5.5 The Tribunal summarised the relevant principles and considerations in relation to the imposition of fines for regulatory offences, which it derived from *R v F Howe & Son (Engineers) Ltd* [1999] Cr App Rep (S) 37, as cited and endorsed by Lord Phillips LCJ in *R v Balfour Beatty Rail Infrastructure Services Ltd* [2006] EWCA Crim 1586 (a case under the *Health and Safety at Work Act 1974* in relation to the Hatfield rail disaster³⁹) as follows⁴⁰:

- “(a) *“Breaches of the regulatory legislation were particularly serious because they were the foundation for the protection of the health and safety of the public.”* The same applied to failure by an auditor to reveal failures by regulated finance services firms in compliance with rules intended to protect the public from financial harm;
- (b) *“Historically fines had been too low.”* This was also true in the context of ICAEW sentencing and under the Joint Disciplinary Scheme, (“JDS”) particularly because there had been a significant change in the scope of work of Member Firms, in the remuneration paid to them and in the responsibilities and risks attaching to the financial activities on which they report;
- (c) *“It is not possible to assert that a fine should stand in any specific relationship with a turnover or net profit of the defendant. Each case must be dealt with in accordance with its own circumstances”;*
- (d) *“It was appropriate to consider how far short the defendant fell of the appropriate standard”;*
- (e) *“A breach with a view to profit seriously aggravates the offence”;*
- (f) *“The degree of the risk and the extent of the danger; specifically, whether it is an isolated failure or one continued over a period.”* This was material in relation to multiple acts of misconduct over several financial periods;
- (g) *“The defendant’s resources and the effect of a fine on its business”;*
- (h) *“Prompt admission of responsibility and a timely plea of guilty; steps taken to remedy deficiencies; a good record”;*
- (i) *“The objective of the fine imposed should be to achieve public safety and bring that message home not only to those who manage a corporate defendant but also to those who own it as shareholders”;*
- (j) *“The stated objective means that consistency of fines between one case and another and proportionality between the fine and the gravity of the offence may be difficult to achieve. Consistency may not therefore be a primary aim of*

³⁹ In which the Court of Appeal reduced a fine of £10 million to £7.5 million on account of the disparity between the £10 million and the fine of £3.5 million imposed on Railtrack. Balfour Beatty’s overall remuneration under its seven year contract was £368 million.

⁴⁰ The passages in italics represent the Tribunal’s summary of the principles approved by the Court of Appeal in *Balfour Beatty*.

*sentencing in this area of law.*⁴¹ This principle, the Tribunal held, should apply to non-criminal sanctions because the circumstances of individual cases are infinitely variable and the standing resources and scope of the work of Member Firms vary very widely;

- (k) “A more serious view can be taken of breaches where there is a significant public element. The fact that a risk has by good fortune or otherwise not eventuated ...with consequences less serious than might have been expected is a relevant factor.””

5.6 In the absence of explicit guidance in relation to the exercise of the powers to impose a financial penalty under the Accountancy Scheme, the Tribunal sought to apply the principles which it had set out. It rejected:

- (a) the suggestion that a financial penalty for defective audit or reporting should be linked to the penalty imposed on the audit subject because quite different considerations apply to the primary actor to those that apply to the auditor and reporting accountant;
- (b) the earlier approach of taking a multiple of the reporting fees in a case involving public interest and the protection of client money, the fee having no necessary relation to the interests protected or the risks associated with non-compliance.

5.7 The Tribunal considered that the upper limit of £500,000 in the majority of JDS Tribunal decisions or £1.2 million in relation to the case relating to the Maxwell companies did not adequately reflect the need to protect the public from risk, the marking of sufficient disapproval of the conduct in question, deterrence of future misconduct, and the size and scope of the business of Member Firms conducting audits on global financial services firms. It concluded that the starting point for the financial penalty in cases such as that one should be the sum of £2 million which might increase to something like £5 million if there were aggravating factors such as an absence of timely correction of systemic or repeated misconduct, recklessness, collusion with the audit or reporting subject, fraud, or the eventuation of risk of financial loss against which the audit or report is intended to protect the public. In the light of various matters of mitigation (full apology, no recklessness, remedial action begun before any complaint was raised, cooperation with the AADB and Executive Counsel, agreement as to the misconduct and facts) it imposed, in addition to a severe reprimand, a financial penalty of £1,400,000. This was described by the City Editor of the Financial Times as “*disgracefully small*”, adding that a fine of £6 million as mooted by the “*tame wig bearer of the [AADB] would have been closer to the mark*”.⁴²

5.8 We have referred to this case at some length for two reasons. First, it sets out principles laid down by the courts in a comparable field. It is desirable that the sanctions imposed under the Schemes and the AEP should not be significantly out of kilter with the principles applicable to regulatory offences where those are relevant. Second, the principles seem to us to afford valuable insight as to the proper approach by FRC

⁴¹ The point addressed in *R v Jarvis Facilities Ltd* [2005] EWCA Crim 1409, paragraph 7 from which principle (j) is derived was that, “a fine that may hardly touch a multi-national might put a small company out of business yet their offence may have been the same”.

⁴² <https://www.ft.com/content/a3f0c736-379e-11e1-a5e0-00144feabdc0?mhq5j=e3>

Tribunals, the existence of which reduces the need for any further revision of the Sanctions Guidance.

- 5.9 The fines that have been imposed under the Accountancy Scheme have increased over recent years, no doubt as a result of a perception that earlier fines were not severe enough⁴³. The AADB Consultation Paper recorded that the AADB considered that historic fines were not an appropriate benchmark for decisions about fines going forward. This was because of the marked increase in the size and scope of the work of Member Firms and market concentration so that a smaller number of firms undertook a larger proportion of audit work. In the period 2013-2016 the mean corporate fine increased from £750,000 to £2,146,667. This increase may well have been influenced by the very large fines that the FCA has imposed on corporations involved in market misconduct. In 2011 the FCA and its predecessor had imposed a total of some £66 million in fines. In 2014 alone it levied £1.47 billion in financial penalties.⁴⁴
- 5.10 The highest fine that has yet been imposed was a fine of £14 million imposed on Deloitte & Touche by the Tribunal in the non-audit case of *The Executive Counsel to the AADB and (1) Deloitte & Touche (2) Magsoud Einollahi* (the “MG Rover case”).⁴⁵ The case concerned the actions of the firm as advisors to companies in the MG Rover Group in relation to the activities of the “Phoenix Four” in respect of “Project Platinum” and “Project Aircraft”. That fine was, however, reduced on appeal to one of £3 million because appeals against the findings of misconduct in relation to Project Aircraft and two of the findings in relation to Project Platinum, including one of failing to consider the public interest before accepting or continuing the engagement of the firm (considered by the Tribunal to be the most serious misconduct), were allowed as was the appeal against a finding of deliberate misconduct. The £14 million was reached by assessing the financial gain by Deloitte & Touche from the fees for the two projects with which the case was concerned with a deduction for the total amount of recorded costs plus interest at 1% over base plus a “deterrent element” which had regard to the loss of funds by MG Rover Group together with the adverse effect on the chartered accountants’ profession arising from the nature, extent and importance of the standards breached. The exact calculation is not apparent. However, between 2000 and 2005 Deloitte & Touche earned £30.7 million being £1.9 million audit and £28.8 non-audit fees from the MG Rover Group.
- 5.11 The highest fine that has been imposed and not successfully appealed is a fine of £5.1 million (£6 million before a settlement discount) imposed on PwC in respect of its handling of the financial statements of RSM Tenon, a professional services business which entered into administration in 2013. The misconduct, which was extensive and

⁴³ We are aware that concern has, for instance, been expressed at the low level of a fine of £2.3 million (£3.5 adjusted by 10% for mitigating factors less settlement discount of £850,000) in the case of *The Executive Counsel of the FRC v (1) PwC and (2) Mr Bradburn*. In that case the net profits after tax for 2007 for Cattles Plc had been overstated by £212 million, its net assets (largely sub-prime loans) by £360.8 million, and its loans and receivables balance by £287.2 million. The inaccuracy in the original 2007 accounts, in respect of which PwC had given an unqualified audit opinion, had a serious impact on shareholders. The City Editor of the Financial Times described such a fine as “feeble” whilst acknowledging that the extent of the bad debt had been concealed from PwC. It was 0.067% of Group Revenue and 0.26% of operating profit for the year ending 30 June 2016.

⁴⁴ <https://www.fca.org.uk/news/news-stories/2014-fines>

⁴⁵ [The Executive Counsel to the AADB and \(1\) Deloitte & Touche \(2\) Magsoud Einollahi](#)

related to five separate areas of the audit, related to the signing off of the accounts for the 12 months to the end of June 2011.⁴⁶

How should fines be calculated?

- 5.12 A very diverse range of views was offered by respondents to the Call for Submissions as to the appropriate starting point (if there was to be one, as some thought helpful even if there was no tariff or guideline/range) for financial penalties (ranging from zero on the “bottom up” principle up to a percentage of the whole firm revenue). Although there was a demand by several respondents for a starting point, there was no consensus on what this should be and several respondents regarded starting points as unduly restrictive and potentially inimical to the proportionality principle.
- 5.13 As to whether financial penalties were too high or too low and, if too low, how high they should go, there was again a very diverse range of views. The differences in level of financial penalty suggested as appropriate for serious misconduct by a large firm were effectively in tens of millions.
- 5.14 Accountancy firms which responded took the view that fines had reached a level which was either already too high or, in any event, should not be exceeded, at any rate for cases not involving dishonesty or recklessness. They had already been increasing over the years without any clear explanation as to why, an increase which, it was suggested, would not improve standards, was not necessary for deterrence and was part and parcel of an excessive focus on financial penalties, which was inappropriate in cases of unintentional fault. There was no evidence that an inadequate level of fines had caused or contributed to a continuance of, or rise in, misconduct. On the contrary audit quality in the United Kingdom is high and AQR results were improving. They pointed out that any fines would be in addition to any civil recovery and accompanying costs, which in the case of audits and other matters could be very sizeable. There was a serious risk that, in the light of possible civil claims and large regulatory fines (with accompanying reputational damage), loss of clients and the ending or blighting of professional careers (even if the charges turned out to be ill founded), accountancy firms, particularly those of a small or medium size, might decline to undertake audit work at all, or restrict the range of audits which they undertook, particularly in relation to those companies most in need of robust auditing.⁴⁷ This, itself, would be very much against the public interest in a market where choice is already limited, particularly in relation to the largest international companies or PIEs. Excessive or overly punitive fines might thus turn out to be counterproductive and defeat the FRC’s role to promote good financial reporting and secure a strong and stable audit market. Such fines, together with the risk of an investigation having the consequence referred to in section 16, may well reduce the attractiveness of audit work to talented new entrants to the profession (fearful of the consequences of honest but serious mistakes) and the willingness of firms to invest in training or new technology.

⁴⁶ <https://www.frc.org.uk/news/august-2017/sanctions-against-senior-auditor-and-pwc>

⁴⁷ One firm described the risk and benefit of auditing PIEs as finely balanced. A fine of £2.275 million imposed on it represented nearly 27% of total profits generated from all statutory audits in one year and a much greater proportion of the profits from the audit of PIEs. Another said that the combination of a £4 million fine together with the costs paid or incurred represented approximately 15% of the annual operating profit from performing statutory audits.

- 5.15 Further, in a paradoxical way, whilst large fines may increase public confidence in the regulator, in its disciplinary role, they may also decrease public confidence in the regulated profession, at any rate if not balanced by publicity for high quality work; and hence in the regulator as overseer of professional standards.
- 5.16 By contrast, we have received submissions that the level of fines is too low and should be much higher in some cases in relation to auditors, if auditors are to be held to account and fines are to have any real deterrent effect. Fines in single figure millions were only a small fraction of the revenues of members of the Big Four,⁴⁸ which dwarf those of other firms;⁴⁹ and there was a real danger that fines at this level would be regarded as no more than a cost of doing business and have little deterrent effect.⁵⁰ Anything less than £5 million for one of the Big Four would not, it was suggested by one respondent, be a major deterrent. What would be of greater concern was publicity which was often the most important outcome of any disciplinary process – in particular firms would not wish to be the one which had received what was currently the largest recorded fine.
- 5.17 We have a number of observations to make on the submissions which have been made to us.

The existing guidance

- 5.18 First, the guidance presently given in paragraphs 31 and 43 of the Sanctions Guidance/Sanctions Policy is that the relevant decision maker should aim to impose a fine that is proportionate to the Misconduct/breach of Relevant Requirements and all the circumstances of the case; which will act as an effective deterrent to future Misconduct/breach of Relevant Requirements; and which will promote public confidence in the regulation of the accountancy profession/of statutory audit and in the way in which Misconduct/breaches of the Relevant Requirements, are addressed. Pursuant to paragraphs 32 and 44 of the Sanctions Guidance/Sanctions Policy, in undertaking the assessment, the relevant decision maker is normally to take into consideration:
- (a) the seriousness of the Misconduct/breach of the Relevant Requirement;
 - (b) in the case of a Member Firm, its size/financial resources and the effect of a fine on its business;
 - (c) in the case of a Member, his financial resources and the effect of a fine on that Member and his future employment; and

⁴⁸ For example, the Tribunal in [The Executive Counsel to the FRC and \(1\) Stephen Harrison and \(2\) PricewaterhouseCoopers LLP](#) recorded that in the year to 30 June 2016 PwC's total revenue was £3,437 million and profit £829 million. Revenue from statutory audits and directly related services was £659 million and revenue from other services to audit clients was £1,427 million. Distributable profit after tax was £323 million; and average profit per partner was estimated at £706,000.

⁴⁹ The Big Four are said to handle 99% of FTSE 100 audits and 96% of FTSE 250 audits: [Developments in Audit 2016/17](#)

⁵⁰ One respondent to the Call for Submissions expressed the view that the monetary penalties imposed up to now had been relatively minor compared with revenues and appeared to have little impact on reputations in the audit marketplace.

- (d) the factors set out at paragraph 18 and 21 of the Sanctions Guidance and the Sanctions Policy respectively.

5.19 We regard this guidance as appropriate. The exercise for which it calls cannot readily be reduced to deciding how far from a particular starting point the Misconduct or breach in question lies, fitting the case into predetermined categories or plotting its position on a graph whose lines match seriousness of misconduct with some measure of financial strength.

Comparison with the Financial Services Authority (“FSA”) and the FCA

5.20 Second, care must be taken in reliance on, or reference to, the level of fines, in tens of millions and beyond, which have been imposed by the FSA and FCA. In many such cases,⁵¹ the entity fined has itself profited in very large measure from its conduct in the market which constitutes a breach of regulatory rules e.g. where there has been market manipulation (as happened in relation to LIBOR and FOREX) or mis-selling, often at the expense of counterparties or consumers, and the offending behaviour has involved some deliberate course of conduct designed to achieve a particular benefit, which may have bordered on, or crossed, the threshold of dishonesty. None of this is usually the case in relation to audits or non-audit accountancy matters. There may, of course, be rare cases where financial statements have been prepared in order to mislead investors and others, to the benefit of the company, and where the auditor has deliberately or recklessly approved them, and profited thereby, in which case the analogy is closer.

The significance of a firm’s size

5.21 Third, in determining a fine the Tribunal must, under the Sanctions Guidance and the Sanctions Policy, take account of the size and financial resources of the Member Firm/Statutory Audit Firm and of the Member/Statutory Auditor and the effect of any fine on its business or him in order to fix it at a level which marks the regulators’ disapprobation and has deterrent effect. But the fact that the Member Firm/Statutory Audit Firm has a very large revenue (much of which may be derived otherwise than from audit services or business with audit clients) does not justify a fine which is disproportionate to the wrongdoing involved on the grounds that such a fine will only represent a small percentage of that revenue. If it were otherwise, under the AEP for example, a big firm which had been guilty of a relatively minor breach of Relevant Requirements in relation to a single audit could find itself paying a fine many times greater than that imposed on a firm with lesser revenue which had been guilty of a much more egregious breach in relation to several. Starting points or ranges, which use a percentage of revenue, gross or net, may, thus, themselves, produce sanctions which are disproportionate to the breach, a disproportion which may work in either direction. At the same time fines must be ones which have an impact on those on whom they are imposed.

The European dimension

5.22 We have taken into account, in this respect, the provisions of EU Law on which the AEP is based. *EU Directive 2006/43/EC* (“the 2006 Directive”) as amended by *EU*

⁵¹ But not, of course, all: see the FCA’s £163 million fine on Deutsche Bank in July 2017 for failing to maintain adequate money laundering controls. \$10 billion, of unknown origin, had been transferred from Russia to offshore bank accounts in a manner highly suggestive of financial crime.

Directive 2014/56/EU (“the 2014 Directive”) and implemented by *Regulation 537/2014* and SATCAR requires competent authorities to be given power to impose various sanctions including “*pecuniary sanctions*”. Article 30b of the 2006 Directive (as amended) concerns the effective application of sanctions and is implemented by regulation 5(3) of SATCAR which states that, when determining the type and level of sanction to be imposed, the competent authority must take account all relevant circumstances including:

- “(a) *the gravity and duration of the contravention;*
- (b) A [i.e. the contravenor]’s degree of responsibility;*
- (c) A’s financial strength;*
- (d) the amount, so far as can be determined, of profits gained or losses avoided by A;*
- (e) the extent to which A has cooperated with the competent authority;*
- (f) any previous contravention by A of a relevant requirement.”*

5.23 Regulation 5(4) of SATCAR provides that A’s financial strength may be determined in such manner as the competent authority thinks appropriate, including –

- “(a) *Where A is a firm, by reference to A’s total turnover; or*
- (b) Where A is an individual by reference to A’s annual income.”*

5.24 Article 30 of the 2006 Directive states that:

*“Member States shall ensure that there are effective systems of investigation and penalties to detect, correct and **prevent** inadequate execution of the statutory audit.”*

5.25 Recital 1 to the 2014 Directive states:

“...in order to reinforce investor protection, it is important to strengthen public oversight of statutory auditors and audit firms by enhancing the independence of Union public oversight authorities and conferring on them adequate powers, including investigative powers and the power to impose sanctions, with a view to detecting, deterring and preventing infringements of the applicable rules in the context of the provision by statutory auditors and audit firms of auditing services.”

5.26 Recital 16 to the 2014 Directive states:

*“Competent authorities should be able to impose administrative pecuniary sanctions that have **a real deterrent effect**, for instance in an amount of **up to one million euros** or higher in the case of **natural persons** and **up to a percentage of total annual turnover in the preceding financial year in the case of legal persons or other entities**. That goal is better achieved by relating the pecuniary sanction to the financial situation of the person committing the breach. Without prejudice to the possibility of withdrawing the approval of the statutory auditor or audit firm*

concerned, other types of sanctions which have a suitable deterrent effect should be envisaged. In any case, Member States should apply identical criteria when determining the sanction to be imposed.”

- 5.27 Those provisions and recitals confirm that deterrence is rightly one of the purposes of the AEP and that the draftsman of the 2014 Directive contemplated sizeable fines, without, however specifying what percentage of total annual turnover might be a maximum. 1% of the annual turnover of some of the Big Four would be about £30 million.

The level of fines imposed by other regulators

- 5.28 Fourth we have considered the level of fines imposed by other international regulatory authorities. The highest fine notified to us by the regulators who responded to our request for information is that imposed by the Financial Services Agency of Japan of 2,111 million yen (approximately £14,000,000) on Ernst & Young ShinNihon LLC, one of the largest audit firms in Japan, in respect of the audits of Toshiba Corporation for the financial years ending in March 2012 and 2013. The fine represented the total of the audit fees for both years. Under the applicable Japanese statute an administrative monetary penalty is to be imposed (by Prime Ministerial order) when an auditor attests that financial documents contain no material false matters, mistakes or omissions, when in fact they do. The penalty is set at the amount of the audit fee received, when the misconduct is due to lack of care, or 1.5 times if the misconduct is intentional. The amount is prescribed and not discretionary. In the United States the PCAOB’s highest fine is one of US \$8 million: see paragraph 5.34 below. Several countries have much lower levels of financial sanctions, and in Canada, the Canadian Public Accountability Board has no power to impose financial penalties.

Our views on level of penalty

- 5.29 Having said all that, we think it appropriate to express our views about the appropriate level of financial penalty. As to any starting point, it seems to us that the irreducible minimum for any financial penalty will, in many cases, be an order for the waiver or repayment of the relevant fees, unless for any reason that is impractical or inappropriate e.g. where the client has ceased to exist, or has acted in a dishonest manner, or been complicit in the wrongdoing or otherwise culpable, (even then, especially in the case of an audit, a return of the fee may be appropriate since it is the function of the auditor to act as a watchdog, albeit not a bloodhound, for the benefit of others). Account may also have to be taken of any value received by the client from the services. Paragraphs 37-39 of the Sanctions Guidance and 52-54 of the Sanctions Policy seem to us satisfactory in this respect. But, as the Sanctions Guidance and the Sanctions Policy recognise (paragraphs 15 and 18 respectively), waiver or repayment of fees is unlikely to be sufficient in itself to reflect the nature and seriousness of the Misconduct/breach of a Relevant Requirement (or the money lost or put at risk) and achieve the purpose of imposing sanctions;⁵² it is normally to be ordered in addition to other sanction,⁵³ and is

⁵² See, for example, The Executive Counsel to the FRC and (1) Stephen Harrison and (2) PricewaterhouseCoopers LLP where the audit fee was £300,000 and the fine £5million.

⁵³ Paragraphs 37 and 52 of the Sanctions Guidance and the Sanctions Policy respectively.

therefore, only in a loose sense, a starting point for assessment of the overall financial sanction.

- 5.30 One criterion for sanctions is that they should secure the disgorgement of any benefit which the individual or firm has secured from the wrongdoing. This, itself, is not without complication. Take an audit. The audit fee will constitute what the firm has received from the audit work but will not represent the net benefit. If account is taken of the non-audit work obtained from the audit client, the nexus between the incompetent audit and the non-audit work may be non-existent. The firm may have got the non-audit work because it was the auditor but the incompetent audit itself may well have had no effect on the non-audit work; and may have played no part in securing it. At the same time, a firm may (consciously or subconsciously) have tempered potential audit criticisms for fear of jeopardising more lucrative or extensive other work;⁵⁴ but that may be difficult to establish. In both audit and non-audit cases it is unusual for the individual or firm to gain any profit or avoid any loss other than that associated with its fees. Considerations such as these illustrate, in our view, the difficulty of some universal guideline (such as a percentage of revenue, gross or net from the audit client for the relevant year(s)) and cause us to prefer guidelines which state a number of guiding principles and relevant factors.
- 5.31 At the other end of the scale it may be helpful to consider what should be the sort of maximum fine for a major firm in a serious case. As to that it seems to us that, if one of the Big 4 firms was guilty of seriously bad incompetence, in respect of the audit of a major public company, where the errors were measured in nine figures or more and there had in consequence been either widespread actual loss or the risk thereof, a financial penalty of £10 million or more (before any discount) could be appropriate as being;
- (a) commensurate with the seriousness of the wrongdoing;
 - (b) a meaningful deterrent; and
 - (c) sufficient to meet the primary objectives of sanctions.

That assumes that the failings did not involve dishonesty or conscious wrongdoing. If they did, the figure could be well above that.

- 5.32 In relation to Misconduct in respect of non-audit matters it would be necessary to take account of the revenue which the firm had earned from it, which may, itself, produce very sizeable figures – see the calculation in the MG Rover case, where, but for the partially successful appeal on liability, there would have been a sanction of £14 million based on net revenue earned plus interest plus deterrence.

⁵⁴ Albeit that article 4 of *Regulation 537/2014* which came into force on 17 June 2016, requires fees for permitted non-audit services paid by a PIE to an auditor to be no greater than 70% of the average of the audit fees paid in the last three consecutive financial years for the PIE. In addition, under article 5, certain non-audited services are prohibited from being carried out. All these matters are reflected in the *Ethical Standard (2016) Integrity, Objectivity and Independence* ([Ethical Standard \(2016\) Integrity, Objectivity and Independence](#)) and are designed to reduce any risk to auditor independence and objectivity and therefore the risk of audit quality being compromised because of the desire to retain other work should reduce.

- 5.33 Any assessment such as that risks characterisation by those who object to it as a figure plucked from the air masquerading as an exercise in judgement. It is nothing of the kind. It is our best estimate of the sort of figure that is likely to be appropriate for a case of that kind, based on our own experience in our respective fields. We recognise that everything will depend on the facts and that assessing a figure in the air is of limited assistance. We do so because of the range of suggestions as to what might be the top end of any penalty.
- 5.34 We have derived assistance from the response to questions directed by us to the PCAOB. This revealed that as of December 31, 2016 the PCAOB had settled 184 cases with \$18.5 million in penalties imposed since 2005, the penalties ranging from \$1,000 to \$8 million. The \$8 million was a settlement enforcement order against Deloitte Brazil. The PCAOB found that Deloitte Brazil knowingly issued materially false audit reports for the 2010 financial statements and internal control over financial reporting (“ICFR”) of its client, Gol Linhas Aéreas Inteligentes S.A. (“Gol”), a Brazilian airline⁵⁵ and that that the firm and certain individuals attempted to cover up audit violations by the improper alteration of documents and provision of false testimony to investigators. In addition to the \$8 million civil penalty Deloitte Brazil agreed to a number of sanctions including:
- (a) a censure;
 - (b) undertakings to improve the firm’s system of quality control;
 - (c) the appointment of an independent monitor to review and assess the firm’s progress in achieving its remedial benchmarks;
 - (d) immediate practice limitations, including a prohibition on accepting certain new audit work until the monitor confirmed the firm’s progress in achieving its remedial benchmarks; and
 - (e) additional professional education and training for the firm’s audit staff.
- 5.35 We regard this as a good example, in a very serious case, of the combination of financial and non-financial sanctions.

⁵⁵ The firm’s failings included failing to obtain sufficient competent evidence that the airline was accurately accounting for its “maintenance deposit” assets (senior members of the firm’s engagement team understood that Gol lacked the necessary support for a potentially material amount of the maintenance deposits it was reporting). The engagement team failed to obtain sufficient competent evidence that Gol’s reported revenue and deferred revenue were materially accurate, and senior members of the engagement team understood that a potentially material misstatement affecting both accounts was still being analysed when it released its audit reports. The firm’s engagement team failed to address red flags indicating that Gol’s ICFR was not operating effectively at year-end 2010.

6. Insurance and indemnification

- 6.1 In many (but not all) cases a firm will pay any fine that is imposed upon an individual and will indemnify him in respect of any costs that he incurs. The circumstances in which the individual is likely not to be supported in this way are, we would assume, where he has been guilty of dishonesty or has deliberately departed from policies or practices laid down by his firm.
- 6.2 We do not think that no fine should be imposed on an individual because the firm will pay it; nor that it should be increased because the firm will do so. If the firm is going to pay, the fine should be appropriate for an individual to pay in relation to the wrongdoing established having regard in particular to his overall remuneration, without any reduction on account of the individual having any difficulty to pay. If the individual is not going to have the fine paid by his firm, and would be in difficulty in paying what is *prima facie* the appropriate fine, that is potentially a good ground for a reduction.
- 6.3 In the case of actuaries, the Actuarial Scheme operates only in respect of Members. If the Member's employer, or the Member's firm pays the fine, the result will be that the total fine imposed will be that appropriate for an individual although it will in practice be satisfied by another entity. That is somewhat anomalous, although the same would apply if a Member in business had his fine paid by his employer. We do not, however, think that the fine should be increased so as to be of the size that would have been imposed on a firm that is subject to the Accountancy Scheme.
- 6.4 In many cases the firm will not be insured against the imposition of any fine. However, some firms will be. In any event, the fact that a firm has insurance against a fine is not something that should increase the amount of the fine over that which would be appropriate. The fact that a firm is uninsured may however be relevant because it will bear on the proportionality, and affect the impact, of any fine.
- 6.5 The Sanctions Policy provides at paragraph 50:

“When deciding the level of financial penalty to impose, a Decision Maker should:

a) when considering a Statutory Auditor or Statutory Audit Firm's financial resources, establish whether there are any arrangements that would result in part or all of any financial penalty being paid or indemnified by insurers, or by a Statutory Auditor's firm, partnership, company or employer. The existence of any such arrangements should not be a ground for increasing any financial penalty beyond the level that would otherwise be considered appropriate by the Decision Maker;”

The Sanctions Guidance contains a similar provision at paragraph 35.

- 6.6 We regard this as an appropriate provision which should remain included in the Sanctions Guidance and the Sanctions Policy. At first blush, it might seem odd to have to establish whether there are any insurance arrangements if such arrangements are not, in any event, to increase any financial penalty; but the relevance of the inquiry stems from the fact that the *absence* of insurance may reduce it.

7. Sanctions imposed by another regulator

7.1 Paragraph 20 of the Sanctions Guidance provides:

*“When determining the sanction to be imposed, a Tribunal **disregards** the fact that sanctions have been, or may be, imposed by another regulator or other authority in respect of the Misconduct or the events related to that Misconduct. A Tribunal takes account of sanctions that have been, or may be, imposed only when considering a Member or Member Firm's financial position (see paragraphs 34, 35 and 36).”*

Somewhat paradoxically, when it comes to preclusion, paragraph 43 of the Sanctions Guidance states that other regulatory sanctions are to be considered.

7.2 Paragraph 23 of the Sanctions Policy provides:

*“When determining the sanction to be imposed, a Decision Maker **will have due regard** to the fact that sanctions have been, or may be, imposed by another regulator or other authority in respect of the breach of the Relevant Requirements or the events related to that breach to ensure that consideration is given to the need to be proportionate, where other sanctions may have addressed the purposes set out at paragraph 10 above and in addition should take account of sanctions that have been, or may be, imposed only when considering a Statutory Auditor or Statutory Audit Firm's financial position (see paragraphs 50-54).”*

7.3 We see no good reason why there should be a difference of approach as between the Sanctions Guidance and the Sanctions Policy and that the approach of the latter is to be preferred, not least because paragraph 20 of the Sanctions Guidance is difficult to square with paragraph 31 which requires the FRC to aim to impose a fine which is proportionate to the Misconduct and “*all the circumstances of the case*”.

7.4 The wording of the Sanctions Policy is confusing. The first part of the paragraph (before “*in addition*”) indicates that due regard shall be paid to sanctions imposed by another regulator, whereas the second half appears to suggest, by the retention, which we think may be a mistake, of the word “*only*” that sanctions imposed by another regulator shall not be taken into account except in relation to the question of financial position.

7.5 In our view, due regard should be taken, in appropriate cases, to the fact that sanctions have already been imposed by another regulator, both in deciding whether or not to proceed against the individual or firm in question and on the question as to what sanction, if any, is to be imposed. If such sanctions are ignored there is a danger that the sanction imposed by the FRC may be disproportionate. We note that a paragraph at page 5 of the IFoA Indicative Sanctions Guidance states:

“Whilst making its own decision, a Panel will have due regard to action already taken in relation to any determination of Misconduct by other bodies (such as courts and regulators)....Any sanction imposed by a Panel is separate from disposal by other bodies (such as courts or other regulators) but a Panel may, where relevant, take account of other such disposals”.

Recommendation 6

We recommend that both the Sanctions Guidance and the Sanctions Policy contain the wording (amended so as to relate to Misconduct) in paragraph 23 of the Sanctions Policy but without the words “*and in addition...50-54*)”.

- 7.6 More problematic is the position in relation to sanctions that may be imposed in the future by another regulator since whether they will be imposed, and in what amount, will be unknown. It is not easy to see how account should be taken of sanctions that may be imposed otherwise than by deciding that the best course is to leave the question of proceeding against the Member with the other regulator, which is unlikely to be satisfactory since the FRC needs to determine whether any, and, if so, what, sanction is needed in the accountancy context.
- 7.7 Submissions were made to us in this connection that, where a number of regulators have an interest in disciplining an individual or a firm, there is a need for coordinated action between those regulators and transparency with the Member about what each of those regulators' intentions are. At present, it was submitted, other regulators dictate the pace of settlement within their own rules without reference to the FRC and its own procedures. Further the FRC, we were told, will usually await the conclusions of a FCA/PRA investigation before initiating its own procedure because paragraph 16(3) of the Accountancy Scheme makes any adverse finding by either of those conclusive evidence of Misconduct and any finding of fact in any proceedings before, or report, by either of those bodies (and others) as *prima facie* evidence of the facts found. While that was efficient from the point of view of the FRC it made it difficult to decide whether to settle because of the difficulty of quantifying what the final total cost might be. One possibility suggested was that the FRC should be willing to consider a settlement with a Member within the same timeframe as the FCA/PRA settlement process on the basis of adverse findings agreed on a without prejudice basis between the member and the FCA/PRA.
- 7.8 Part of the problem lies in the fact that, in many cases, another regulator is the lead regulator, which is, for instance, concerned with the failings of a company and its management, to which any failings of the auditors are secondary. There may well be good reasons why progress on the part of the FRC is held up in the light of the activities of the lead regulator. It may have, or have the prospect of getting, information which the FRC lacks, which it may be able to share with the FRC. There may be something of a queue to interview witnesses. Moreover, a wish to rely on the findings of a lead regulator which are binding in an FRC context is perfectly legitimate.
- 7.9 Further, it is always open to a respondent to invite the FRC to deal with his case at the same time as the lead regulator and for that purpose to authorise the lead regulator to exchange information which he has provided to it with the FRC.

8. Non-financial sanctions

- 8.1 One of the matters that we were specifically asked to consider was the effectiveness and fairness of the range of sanctions available. In this connection several respondents to the Call for Submissions pressed on us the prime importance of audit quality and its critical role in generating trust and confidence in capital markets. Other than in cases involving a lack of integrity, intentional misconduct or recklessness, large financial penalties, were not, it was submitted, the answer. The Sanctions Guidance and the Sanctions Policy, or at any rate the implementation thereof, placed too much emphasis on financial penalties, such that a financial penalty had become the expected outcome of the disciplinary process, when that did not have to be so. Sanctions in relation to statutory audit work should be designed and applied for the purposes of improving its quality. The overwhelming majority of respondents felt that greater use should be made of non-financial sanctions, with many suggesting that such sanctions would be more likely to ensure that the objectives of sanctions were achieved and public confidence built up and sustained.
- 8.2 As we have indicated, we do not accept that substantial financial penalties should be limited to cases of lack of integrity, intention or recklessness. What we do accept is that greater attention needs to be given than has been the case in the past to the use of non-financial penalties, particularly given the fact that the AEP will apply to failings which would not constitute Misconduct under the Accountancy Scheme. Since the purposes of a sanctions regime include the declaration and upholding of proper standards and the protection of the public from those whose conduct has fallen short, and, in our view, should be expanded to cover the maintenance and enhancement of the quality and reliability of accountancy and future audits, the use of sanctions which may themselves lead to an improvement in quality of work both by those who have offended and more generally falls four square within the objective.

Recommendation 7

We recommend that greater attention should be given than has been the case in the past to the use of non-financial penalties.

Exclusion, preclusion or temporary prohibition from practice

Individuals

- 8.3 In the case of individuals, suspension or expulsion will be appropriate if there has been dishonesty, intentional wrongdoing or recklessness. In respect of dishonesty we think that the guidance should make particular provision. Dishonesty is so inimical to everything that a profession stands for, and so destructive of public confidence, that those who are guilty of it have no place in the profession and should normally be excluded for a substantial period and, quite possibly, never admitted to it again. When a Tribunal or other decision maker decides that an individual should be excluded as a Member of one or more Participants it recommends a period of time for such exclusion. Although the individual can apply for re-admittance before the expiry of the period he is unlikely to secure that, and, even after the expiry of the period, he will still have to ask for readmission. In our view where an individual has been found to have been

dishonest the recommendation should normally be that he be excluded for at least 10 years.

Recommendation 8

We recommend that the Sanctions Guidance and the Sanctions Policy contain a provision that where an individual has been found to have been dishonest the recommendation should normally be that he be excluded from membership for at least 10 years.

- 8.4 Restrictions on an individual carrying out work or the imposition of conditions and even exclusion may, of course, be necessary even in the absence of dishonesty, intentional wrongdoing or recklessness, if the protection of the public requires it.

Firms

- 8.5 Precluding a firm, particularly one of any size, or part of a firm, from carrying out work of a particular kind, at any rate if it is to be for any length of time, is far more problematic since it may prejudicially affect;
- (a) the public which will be deprived of services which may not necessarily be available elsewhere; and
 - (b) members or employees of the firm who are free from any blame whatever.

It may, however be necessary if, for instance, there has been dishonesty or deliberate wrongdoing or an egregious level of incompetence which the firm has not addressed.

- 8.6 We have no doubt that decision makers are well aware of the limited circumstances in which it may be appropriate to prevent a firm from carrying out work. There is currently no case in which that has been ordered. The Sanctions Guidance and the Sanctions Policy contain all the powers necessary to make the right decisions on these matters and we see no need for any change or for there to be some express inhibition on restricting a firm from work.

Other non-financial sanctions

- 8.7 In the case of individuals, non-financial penalties short of exclusion, preclusion or temporary prohibition are likely to involve requirements for training or retraining or other education, mentorship or mentoring schemes, resitting of professional examinations and no doubt others.
- 8.8 In the case of firms, they may extend to such matters as:
- (a) submission and execution of remedial action plans, training programmes or quality assurance measures, perhaps with mandatory investment to a specified extent;
 - (b) education, training or retraining for individuals or particular units;

- (c) requirements for improved systems, controls and procedures with a view to changing behaviour;
- (d) independent verification by outsiders; and/or
- (e) certification from a senior figure in the firm that what is required has been carried into effect; and
- (f) if necessary for the protection of the public, restrictions on practice for the whole or part of the firm whilst the necessary remedial action is taken, for a limited period.

8.9 There may also be scope for requiring firms to provide at their expense training programmes in particular areas for the use of the professional body to which they belong, or the profession as a whole, or other initiatives for the benefit of the profession. In appropriate cases the willingness of a firm to take any of these measures, particularly if it is costly to do so, may justify the reduction or elimination of any fine. In addition, measures, such as a deferred sanction, may need to be taken to see that required actions or improvements are in fact implemented.

8.10 We do not think that the Sanctions Guidance or the Sanctions Policy themselves require substantial alteration in this respect since sufficient power to use non-financial sanctions already exists. The range of sanctions available is adequate. What may be needed is a reconsideration of approach. Our recommendations for change in the terms of the Sanctions Guidance and the Sanctions Policy are, therefore, few.

8.11 Our recommended amendment to the Sanctions Policy, by the inclusion of an objective “*to maintain and enhance the quality and reliability of future audits*” may serve to focus attention on the desirability of adopting sanctions calculated to improve the quality of future audits not only for the individual firm concerned but for the profession generally.

Recommendation 9

We also recommend adding to the Sanctions Guidance a requirement to consider, particularly in the case of Members/Member Firms with no disciplinary record:

- (a) whether, and, if so, to what extent, the sanctions proposed would be likely to lead to improvements in the failings which gave rise to the proceedings and in the quality of work of the Member/Member Firm concerned; and
- (b) whether the objectives of the Scheme can be achieved without a financial penalty, or with a lesser financial penalty, by the use of non-financial sanctions such as a Reprimand or Severe Reprimand and the acceptance of undertakings or the giving of directions such as those referred to in paragraph 27 of the Sanctions Guidance or the formulation and carrying out of initiatives which are calculated to improve the quality of work of the Member or Member Firm, or of the profession as a whole together, where appropriate, with supervision or monitoring or other quality assurance measures or restrictions.

and making a similar addition to the Sanctions Policy.

Reprimands

- 8.12 Some respondents suggested that further clarification was desirable as to the circumstances in which there should be a Severe Reprimand as opposed to a Reprimand.
- 8.13 We do not regard this as necessary. A Severe Reprimand is obviously more serious than a Reprimand and is appropriate if there has been seriously defective audit or accountancy work or serious negligence. A Reprimand is likely to be appropriate only where the failings are not of any great seriousness and by a first-time offender. It would in all probability have to be accompanied either by a fine or some other remedial measure. Any judgement as to the degree of seriousness of the conduct in question and, in consequence, the type of reprimand needed must depend on the facts of individual cases.

9. Individuals viz-a-viz entities

9.1 We invited submissions as to whether the focus of sanctions should be on individuals or entities. Perhaps unsurprisingly, the majority of respondents took the view that the answer was that the FRC must consider the actions or inactions of both and that the nature and degree of sanction should depend on responsibility for the failings in question. A small minority of respondents took the view that sanctions should be imposed on individuals rather than firms; or that the primary focus should be on individuals; or that individuals were dealt with lightly compared with firms and that stiffer sanctions would, as one respondent put it:

“encourage individuals in firms to withstand the pressure to cut corners, save costs or avoid difficult issues with valuable clients.”

9.2 One view expressed was that a sanction on a firm should only be imposed when the FRC had determined that the breach has been caused by some form of collective behaviour or institutional failing. Another was that in cases of error of judgement not involving dishonesty or lack of integrity there was no need for a separate sanction against individuals.

9.3 We entirely accept that the focus and degree of sanction (if any) imposed on firms and individuals must depend on the particular facts and the degree of responsibility for the failing as between the individual and entities concerned; and that fines on individuals may require to be such as will have real impact on an individual as well as a firm. Importantly, individuals should not be left out of investigation or proceedings if they were apparently at fault.⁵⁶ We do not accept that firms should be wholly or largely exempt from sanction in the absence of what can be described as “collective behaviour” or “institutional failing”. Such an approach would enable a firm to avoid any financial sanction, even a return of the audit fee, if the failing did not fall within such a rubric; and would do little to mark what might be a serious breach or hold to account the firm which, by its partner(s) or employees, had committed it. In reality, most cases are likely to involve responsibility both on the part of the firm and the individual(s).

9.4 Nor do we accept that there should be no, or no substantial, sanction against an individual simply because he was not dishonest or lacking in integrity. That would allow those who were seriously negligent, cut corners or tolerated risky practices to escape sanction. We are also not persuaded that the Sanctions Guidelines or the Sanctions Policy require any amendment to encourage firmer sanctions against individuals for whom the process is, as we observe in paragraph 16.3, inevitably burdensome. Nor is one needed to permit the rare cases where an individual should receive no sanction at all.

Accountants in business

9.5 We think that the FRC needs to be astute to investigate complaints against accountants in business and, where appropriate, institute proceedings. This is particularly (but not exclusively) in the audit context; not least because auditors may have a justified sense

⁵⁶ We note, in this connection, that in the *PwC re JP Morgan* case the Tribunal expressed surprise and concern that no partner was named by the FRC or proceeded against by the Executive Counsel, and, in the absence of any reason being given for not doing so, simply trusted that there had been no bargaining of PwC’s admission against an agreement on anonymity for individuals in the firm who were responsible for what was a serious state of affairs.

of grievance if those who are subject to the same or similar professional obligations and who may be the persons primarily at fault (and sometimes guilty of intentional misconduct) are not investigated when they are. Auditors should not be seen as the only potentially culpable accountants when some egregious failure, or scandal, arises.

- 9.6 One suggestion made to us was that there should be an expansion of the FRC's powers to cover directors and audit committee members who are not members of the relevant accountancy bodies. Whilst that suggestion has merit we regard the question as outside the scope of this review.

10. Compensation

- 10.1 We have considered whether the Sanctions Guidance or the Sanctions Policy should be amended so as to encourage Tribunals to require the payment of compensation. We do not think that they should. The question of compensation is primarily one for the civil courts. The range of those to whom, as a matter of law, obligations are owed by accountants, auditors and actuaries is limited.
- 10.2 Generally speaking, it would be inappropriate for Tribunals to grant what amounted to a civil remedy to those who are not at law entitled to it, or to seek to rule on a question of entitlement to compensation which involved difficult questions of law. Even if compensation may be legally due in principle, what compensation is to be awarded, to whom and to what extent is likely to raise difficult questions of fact with which the Executive Counsel and Tribunals are not best placed to deal, the resolution of which would be likely significantly to delay the progress of proceedings. It may be that in a particular case a requirement of compensation might be appropriate. But the existing Sanctions Guidance/Sanctions Policy does not require alteration to allow that to happen.

11. Settlement

Settlement discounts

11.1 The questions that arise under this heading are somewhat intricate, because of the structure of the Sanctions Guidance and the Sanctions Policy. In essence our views are:

- (a) that there should be a discount for early settlement;
- (b) that a somewhat greater incentive should be provided for timely settlement in that a discount of 35% should ordinarily be available if settlement takes place within one month after the delivery of a Formal Complaint under the Schemes or up to the issuance of an acceptance of Executive Counsel's Decision Notice in accordance with Rule 17 under the AEP;
- (c) that a discount of up to 20% in the case of the Schemes and of up to 15% under the AEP should not be available if settlement takes place only in the month before the hearing;
- (d) that the full discount should not only be available if the Member/Member Firm or Statutory Auditor/Statutory Auditor Firm admits substantially all the heads of complaint of the Formal Complaint/all the Adverse Findings in the Decision Notice; and
- (e) that an appropriate level of discount should be allowed where the Member/Member Firm or Statutory Auditor/Statutory Auditor Firm agrees the facts and liability but not the level of financial sanction or discount - a level of discount which will probably be less than the discount applicable if the person concerned had agreed the level of sanction and discount which the decision maker thinks appropriate.

11.2 The Sanctions Guidance provides:

“59 For the purpose of providing guidance on the scale of any settlement adjustment, the FRC recommends that a case should be divided into three stages and a settlement factor applied to each stage:

- *Stage (1) - the period from receipt by the Member or Member Firm of the decision to commence an investigation in accordance with paragraph 7(4) of the Scheme until the delivery of a Formal Complaint in accordance with paragraph 7(11) of the Scheme – a reduction of between 20 and 35%;*
- *Stage (2) - the period from delivery of a Formal Complaint in accordance with paragraph 7(11) until the commencement of the hearing of the Formal Complaint by the Tribunal – a reduction of up to 20%;*
- *Stage (3) - the period following the commencement of the hearing of the Formal Complaint by the Tribunal until the final conclusion of the case, including any appeals – no reduction.”*

11.3 The Sanctions Policy relates to the AEP which involves an addition to the chain of decision makers because there has to be a Decision Notice by the Executive Counsel and then the Enforcement Committee. It has, thus, a slightly different set of provisions:

“76 For the purpose of providing guidance on the scale of any adjustment for early disposal, the FRC recommends that a case should be divided into four stages and a range of reductions applied to each stage:

a) Stage (1) – resolution up to the issuance of OR acceptance of Executive Counsel's Decision Notice in accordance with Rule 17 — a reduction of between 25 and 35%;

b) Stage (2) – (following non-acceptance of Executive Counsel's Decision Notice) resolution up to the issuance of OR acceptance of the Enforcement Committee's Decision Notice in accordance with Rule 24 — a reduction of between 15-25%;

c) Stage (3) – (Following non-acceptance of the Enforcement Committee's proposed Decision Notice) settlement up to the commencement of any Hearing – a reduction of between 5-15%.

d) Stage (4) - the period following the commencement of the Hearing until the final conclusion of the case, including any appeals — no reduction”.

11.4 Almost all of those who responded to the Call for Submissions on this topic thought that a settlement discount should be used, although one thought there was an argument that cooperation should be taken as read rather than “rewarded” and another thought that the general public might see discounts as evidence of the FRC/tribunal being “a little too friendly” to those found guilty of an infringement; another thought that there was a risk than an actuary would accept a reduced settlement and other sanctions for financial reasons when, had the Tribunal sat, the outcome of the case may have been in the actuary’s favour. Another respondent thought the same in relation to smaller firms of accountants.

11.5 We are entirely satisfied that there should be discounts for settlement. It is, generally speaking in the interests of all concerned – the FRC, the individual/the firm and the public - that resolution of cases takes place with despatch; and that respondents to disciplinary charges are encouraged to make timeous admissions and square up to their failings. It is a feature of criminal, and many disciplinary, procedures.

11.6 Two respondents thought that the discount provisions did not provide enough incentive for firms or the FRC to have meaningful discussions either on discounts or settlements; and two felt that greater distinction in the content of discount should be made between those who were guilty of dishonesty or lack of integrity and others. A number of respondents said that there should be greater incentives for early settlement and a more collaborative approach to enforcement in which audit firms would be encouraged to make admissions and to enter into settlement discussion at an early stage. Such an approach might include identification of lessons to be learnt by the audit firm and a requirement for the firm to communicate key learnings internally and a commitment to take follow up action such as the provision of training to all audit staff and ongoing monitoring if necessary.

11.7 We think that the settlement discount provisions could be improved so as to encourage settlement. We note that the FRC Enforcement Division was strongly of the view that ranges of percentage discounts should be reviewed to ensure that there are far greater incentives for early settlement.

11.8 As matters stand a Formal Complaint under the Schemes will have been preceded – see paragraph 7(10) of the Schemes - by a draft on which the Member or Member Firm is invited to comment, for which purpose the Member or Member Firm is to be given a period of eight weeks (extendable by the Executive Counsel) in which to make written representations. We would regard it as appropriate for the 35% discount usually to be available until a short time after the delivery of the Formal Complaint, since it is in that complaint that the precise allegations that are to be made are set out.

11.9 Accordingly we suggest that Stage 1 should provide:

*“- the period from receipt by the Member or Member Firm of the decision to commence an investigation in accordance with paragraph 7(4) of the Scheme until **one month after** the delivery of a Formal Complaint in accordance with paragraph 7(11) of the Scheme – a reduction of between 20 and 35% **and ordinarily 35%**;*”

11.10 We suggest that Stage 2 should provide:

*“- the period from **one month after** delivery of a Formal Complaint in accordance with paragraph 7(11) until **a month before** the commencement of the hearing of the Formal Complaint by the Tribunal – a reduction of up to 20%;*”

11.11 We do not think that a settlement the day before the commencement of the hearing should attract a reduction of up to 20%.

11.12 There would then need to be a Stage 3 which provided:

“- the period from one month before the commencement of the hearing of the Formal Complaint by the Tribunal until the commencement of that hearing – a reduction of up to 10%;”

11.13 The existing Stage 3 would then become Stage 4 and the third line of paragraph 59 would refer to four stages.

11.14 Paragraph 17 of the AEP provides that Executive Counsel’s Decision Notice shall outline the Adverse Findings with reasons, propose a Sanction with reasons and an amount payable in respect of his costs, and invite the respondent to provide a written agreement as to all or part within 28 days or such longer period as he may agree is reasonable in all the circumstances. We recommend that stages 1 – 3 should provide:

*“a) Stage (1) - resolution up to the acceptance of Executive Counsel’s Decision Notice in accordance with Rule 17 — a reduction of between 25 and 35% **and ordinarily 35%**;*

b) Stage (2) – (following non-acceptance of Executive Counsel’s Decision Notice in accordance with Rule 24 — a reduction of between 15-25%;

*c) Stage (3) – (Following non-acceptance of the Enforcement Committee's proposed Decision Notice) settlement up to a **month before** the commencement of any Hearing – a reduction of between 5-15%.*

and that there should then be:

d) Stage (4) - during the month before the commencement of the Hearing – a reduction of up to 10%.

11.15 The existing stage (4) would then become stage (5) and the opening words of paragraph 76 would refer to five stages.

Recommendation 10

We recommend that amendments be made to the Sanctions Guidance and the Sanctions Policy as set out in paragraphs 11.9 to 11.15 above.

11.16 In our view any discount should not apply to any part of the proposed penalty which equates to the disgorgement of a profit made or loss avoided or the repayment or waiver of a fee. Such elements are largely restitutorial in character and a discount on them is inappropriate.

Recommendation 11

We recommend that the Sanctions Guidance and the Sanctions Policy should contain a similar provision to that contained in paragraph 6.7.2 of the FCA DEPP Manual to the effect that where part of the proposed penalty equates to the disgorgement of a profit made or loss avoided or constitutes the repayment or waiver of a fee, the discount shall not apply to that part of the penalty.

11.17 Paragraph 60 of the Sanctions Guidance provides:

“An adjustment to reflect a settlement at the higher end of any range will only be appropriate if the Member or Member Firm admits substantially all the heads of complaint of the Formal Complaint or does so at an early stage of the case. If the Member or Member Firm is prepared to admit some but not all the heads of the Formal Complaint, the discount applicable will depend on the extent and significance of the admissions as well as the stage at which those admissions were made.”

Paragraph 77 of the Sanctions Policy is to the same effect.

11.18 We question the advisability of this and are puzzled as to how it is supposed to work. Under a settlement the parties will agree to certain findings. If that is done by the time stipulated we cannot see that the discount should be reduced because the individual or firm concerned has not admitted substantially all the heads of complaint. They will have admitted those heads of complaint which are required to be admitted if there is to

be a settlement of the proceedings. We, also, suspect that the “or” in the two paragraphs was intended to be an “and”.

- 11.19 If the individual/firm agrees some but not all of the matters which the Executive Counsel seeks to have agreed, and the case proceeds to a hearing in respect of the matters in dispute, and the Executive Counsel proves more than the individual/firm was prepared to admit some discount may still be necessary to reflect what was admitted. It may be that this was the point at which paragraph 60 of the Sanctions Guidance was directed.

Recommendation 12

We recommend excising paragraph 60 of the Sanctions Guidance and paragraph 77 of the Sanctions Policy.

- 11.20 One submission made to us was that respondents ought to be allowed to agree facts and liability and contest the appropriate settlement, with certainty as to the settlement discount which would be given to them to reflect the extent that issues have been settled and admissions made.

- 11.21 The Sanctions Guidance already contains the following paragraph 61:

“Where, Executive Counsel and the Member or Member Firm attempt to agree an appropriate discount, but are unable to do so, the discount to be applied shall be determined by those responsible for authorising the settlement agreement in accordance with paragraph 8 of the Scheme.”

- 11.22 If, therefore, everything is agreed except the level of discount, then the level of discount falls to be decided by those responsible for authorising the settlement. If the decision maker agrees with the discount proposed, the proposer will get that discount. The problem arises if the decision maker agrees that there should be a discount but not the one proposed by the Member/Member Firm. A similar problem arises if everything is agreed except the sanction to which any discount should be applied.

- 11.23 We understand the suggestion to be that Members/Member Firms should be entitled to agree the facts and their liability but to contest either the financial sanction or the appropriate discount, or both; and that, if they do, they should get a minimum discount appropriate for the time at which they signified their agreement of which they are made aware in advance of making that agreement.

- 11.24 We agree that, if the facts and liability are admitted, but the financial sanction or the discount thereon, or both, are in dispute, some discount should usually be allowed, even though there has been no settlement and the decision maker concludes that the financial sanction should be more or the discount less than that for which the Member/Member Firm argued. We do not, however, accept that, if the decision maker does not agree with the level of sanction or the discount thereon proposed, the Member/Member Firm should receive exactly the same discount as he/it would have received if a settlement had been reached. We do not think it appropriate to stipulate some precise rule as to

what level of discount should be given in the event that a Member/Member firm agrees the facts but disagrees with the proposed settlement figure or the applicable discount.

Recommendation 13

We recommend that the Sanctions Guidance should provide that, where the Member or Member Firm agrees the facts and liability, but not the level of financial sanction or the appropriate discount, the decision maker should allow such discount as is thought appropriate having regard to all the circumstances and, in particular, the time when the facts and liability were agreed and the sanction and discount proposed by the Member or Member Firm.

11.25 The Sanctions Policy contains in paragraphs 78ff provisions about Partial Admissions. These include paragraph 81 which says:

“Partial admissions may be relevant to the factors considered by the Enforcement Committee or Tribunal at the point it determines sanction but there is no formal adjustment of sanction to be applied in cases where there has not been early disposal. Respondents who are ordered to pay costs may benefit from lower costs where partial admissions have enabled investigation, presentation and Committee or Tribunal time to be reduced.”

Recommendation 14

We recommend that paragraph 81 of the Sanctions Policy is slightly reworded so as to read:

“Partial admissions may be relevant to the factors considered by the Enforcement Committee or Tribunal at the point it determines sanction but there is no formal adjustment of sanction to be applied in cases where there has not been early disposal. Nevertheless, where the Statutory Auditor or Statutory Auditor Firm agrees the facts and liability, but not the level of financial sanction or the appropriate discount, the decision maker should allow such discount as is thought appropriate having regard to all the circumstances and in particular the time when that was agreed and the sanction and discount proposed by the Member or Member Firm. In addition, Respondents who are ordered to pay costs may benefit from lower costs where partial admissions have enabled investigation, presentation and Committee or Tribunal time to be reduced.”

Incentives for settlement

11.26 As already indicated, a number of respondents submitted that the present system does not incentivise either the Executive Counsel or the firms to have meaningful two-way discussions at an early stage and does not incentivise admissions and/or settlement. The prolonged period of investigation was one problem. Another was that the Proposed Formal Complaint may be the first time that the precise details of the complaint will be available. A third was there was no scheme of mediation or settlement before a Formal Complaint was finalised. One complaint was that the FRC was less likely to engage in

settlement discussion after a formal complaint had been served – hence the desirability of some form of Part 36 offer.

11.27 In a situation where;

- (a) both those in charge of enforcement and those affected by it are, rightly, keen on securing an early resolution of cases;
- (b) the applicable procedures provide for respondents to be given considerable notice of proposed Formal Complaints or Adverse Findings; and
- (c) there is a generous discount available for timeous settlement,

we are somewhat surprised at the submission that the present system does not incentivise admissions or settlement.

11.28 We would observe that proceedings by a regulator are not entirely comparable to ordinary civil proceedings. If A claims £ 100 from B and B says he owes £ 0, A and B may be prepared to settle for something between £ 0 and £ 100. A mediator may help them to that result. But a regulator has public duties to perform; and is not in the business of bartering a reduction in what he regards as the necessary basic level of sanction in exchange for early settlement.

11.29 We understand that the Enforcement Division endeavours to give information as to the type of sanction it has in mind at an early stage and is prepared to have sensible settlement discussions provided that it has been able to investigate matters to its satisfaction. In those circumstances, we do not think that there is some further recommendation that we can or should make other than to encourage that approach. We note that the number of settlements is increasing; and nothing that we have seen persuades us that the system militates against settlement.

12. Cooperation

- 12.1 Both the Sanctions Guidance (paragraph 54) and the Sanctions Policy (21(f) and 64b) list cooperation as a mitigating factor that can result in reduced financial penalties. One complaint made was that no information is given on what constitutes good cooperation, and what level of fine reduction will be given to cooperating firms/individuals. This is said to reduce the incentive to cooperate with FRC investigations because:
- (a) it is unknown what the benefit of cooperating will be; and
 - (b) it is unclear what exactly counts as cooperative behaviour.

More guidance would, it is suggested, be helpful.

- 12.2 Cooperation may take several forms. The prime example is where an individual or firm reports him/itself to the FRC. Cooperation will also be shown by dealing timeously, properly and fully with requests by investigators, not placing inappropriate obstacles in the way of progress; or seeking without good reason to delay either the investigation or the disciplinary proceedings. We rather doubt that it is necessary to spell out to professional accountants what cooperation means in this context. Cooperation is, in any event, what the FRC is entitled to expect – so that any reduction on account of the fact that the individual or firm was not uncooperative may not be much. That said, there are degrees of cooperation. An individual or firm may volunteer information that he/it was not asked to provide or provide that which he was entitled to withhold e.g. because it was legally privileged. He/it may alert the Executive Counsel to relevant issues, or to relevant material or witnesses, and help him to find them. He/it may direct attention to the potentially relevant parts of bulky material which has been provided. Cooperation which is, in a sense, beyond the call of duty may merit reduction of financial penalty.
- 12.3 We suggest that the FRC and in particular the Executive Counsel should consider whether further examples could be given in the Sanctions Guidance and the Sanctions Policy as to what “cooperation” may include – aided, perhaps, by identifying the opposite of that which has been regarded as uncooperative behaviour.
- 12.4 We also take the view that there may be cases where a discount of up to 50% of any financial penalty is appropriate. This might arise, for instance, where no dishonesty or want of integrity was involved; where a firm had reported itself to the FRC, had shown insight into what went wrong, had carried out all necessary remedial measures speedily and had cooperated fully at every stage and had agreed the facts and its liability very early on. We recognise that care must be taken to ensure that the justification for such a discount is evident.

13. Reasons for decisions

- 13.1 Decisions of Tribunals and other decision makers under the Schemes/AEP involve giving reasons. Settlements, which have to be approved by Tribunal Chairs/Tribunals, indicate the matters taken into account. Complaint is made that the reasons given by Tribunals and the terms of Settlement Agreements are, in practice, not sufficient for a firm, or a member of the public, to determine what penalty, and in particular what level of fine, if one is to be imposed, is likely for the conduct in question. Any attempt to work out the proper or likely level of fine would require looking at the published decisions and, even if that is done, discernment of a clear pattern or guide to sentencing is absent.
- 13.2 Considerations such as these are relied on in relation to the call for a tariff or guideline, which we have rejected for the reasons set out above. We are conscious that, in the absence of either of those, reasons given by Tribunals and other decision makers for the level of fines in individual cases are likely to be of a somewhat general character e.g. that a fine of the amount in question was what was necessary in the light of the seriousness of the facts and the aggravating and mitigating features as spelt out in the ruling. However, it seems to us that a choice has to be made between some form of specific tariff or guideline and the more high-level guidance which is currently provided. Given that choice, we prefer the latter. That makes it all the more important for Tribunals and other decision makers to give as much reason as possible as to why a particular sanction was chosen.
- 13.3 It does, however, seem to us desirable, subject to any legal constraint and, save as provided by paragraph 9 of the AEP Publications Policy, that the decisions of Tribunals and other decision makers, including approved Settlement Agreements, are available in one readily accessible place on the FRC website, together with a summary of the cases containing at least:
- (a) the name of the respondent(s);
 - (b) the sanctions imposed;
 - (c) a brief summary of the Misconduct/breach of a Relevant Requirement established indicating what went wrong; and
 - (d) a link to the relevant document such as a Tribunal report or Settlement Agreement.
- 13.4 The ready availability of this information would contribute to a more general understanding of the type of wrongdoing which is likely to attract sanction and to the process of avoiding repetition, and would enable the public to have a full awareness of what the FRC is doing in this context.

Recommendation 15

The FRC should make available in one readily accessible place on its website information in respect of disciplinary outcomes as set out in paragraph 13.3 above.

14. Precedent

- 14.1 Although this is a field in which consistency of treatment in comparable situations is desirable, so that there is no wide discrepancy between penalties imposed by different Tribunals for wrongdoing of the same order of magnitude by comparable offenders, a number of problems arise in relation to the use of past cases as a guide to appropriate sanction.
- 14.2 First, in practice, no two cases are the same and, as Tribunals have from time to time observed, it may not be particularly profitable to examine how comparable one case is to another⁵⁷. Second, time marches on, during which appreciations of the level of financial sanction necessary to fulfil the policy objectives may justifiably change, particularly in the light of societal and commercial developments⁵⁸. Third, there is a danger of what might be termed precedential cramp. A particular settlement may take place in which the fine is relatively moderate. In deciding what fine to seek in subsequent cases, the individual or firm concerned will, inevitably, seek to compare his/its situation with the supposedly paradigm case in order to contend that the fine in his/its case should be lower or cannot be higher. The Executive Counsel may feel constrained by the case in question to settle for a fine which, in truth, he thinks too low. A Tribunal or Tribunal Panel Legal Chair faced with a request for approval of the settlement may then be reluctant to withhold approval even though they have considerable doubts about the appropriateness of the figure proposed. Thus, the case in question may set for an indefinite period a ceiling on financial penalty which may not, or no longer, be appropriate.
- 14.3 Paragraph 7 of the Sanctions Guidance provides that:
- “The guidance should be considered alongside any precedents emerging from cases decided by previous Disciplinary Tribunals and Appeal Tribunals.”*
- and paragraph 8 of the Sanctions Policy provides that:
- “The guidance should be considered alongside any principles emerging from cases decided by previous Decision Makers under the Audit Enforcement Procedure.”*
- 14.4 One problem with the former formulation is that decisions of both sets of Tribunals are unlikely to have been composed as, or designed to be, precedents intended to constitute guidelines for future cases. The Criminal Division of the Court of Appeal of England & Wales lays down what are intended as, and are stated to be, guideline cases for the future, and deprecates the citation of decisions on sentences in other cases as a guide to resolution of the instant case before it. The same view as to the lack of assistance from sentencing decisions in other cases was expressed by Sharp LJ in *Scott v Solicitors Regulation Authority* [2016] EWHC 1256 (Admin) and relied on by the Tribunal in the case of *The Executive Counsel to the FRC and (1) Stephen Harrison and (2)*

⁵⁷ See paragraph 34 of the Report of the Appeal Tribunal in the *MG Rover* case in respect of sanctions: “We do not think it appropriate to seek to compare this case with other decided cases.... the wide difference in facts and contexts renders a comparison unhelpful”.

⁵⁸ As the Tribunal put it in the case of *The Executive Counsel to the FRC and (1) Stephen Harrison and (2) PricewaterhouseCoopers LLP* at paragraph 304.

PricewaterhouseCoopers LLP at paragraph 331. One of the principles approved in *Balfour Beatty* was that,

“the stated objective means that consistency of fines between one case and another and proportionality between the fine and the gravity of the offence may be difficult to achieve. Consistency may not therefore be a primary aim of sentencing in this area of the law.” See paragraph 5.5 above.⁵⁹

- 14.5 The problems referred to above are compounded by the fact that the number of decided cases, either by way of settlement or following a hearing under the Schemes is small; and there have, as yet, been no decisions under the AEP.

Recommendation 16

We recommend that the wording of paragraph 7 of the Sanctions Guidance should follow the wording of paragraph 8 of the Sanctions Policy, and that wording was added to both these paragraphs along the following lines:

“Decision makers may have regard to sanctions imposed in other cases. They must, however, determine the sanction which they think appropriate on the facts and circumstances of the case before them and should not feel constrained by the sanctions imposed (or not imposed) in earlier cases to impose a sanction which they do not think appropriate.”

⁵⁹ See also the judgment of Wynn Williams J in *Shah v General Pharmaceutical Council* [2011] EWHC 73 where he found that a number of previous decisions of the statutory committee under the *Pharmacy Act 1954*, where some form of reprimand had been ordered but not removal from the register, did not amount to a “consistent body of jurisprudence” or the establishment of some form of norm but simply constituted a series of examples of cases decided on their own facts which had some similarity to the case in question.

15. Costs

- 15.1 Several respondents suggested that the position on costs under paragraph 9(10) of the Accountancy Scheme, (replicated in paragraph 9(10) of the Actuarial Scheme) whereby a Disciplinary Tribunal's discretion to award costs,

“shall be restricted to circumstances where the Tribunal finds that no reasonable person would have delivered or pursued all or a substantial part of a Formal Complaint under the terms of the Scheme”,

and the similar position under paragraph 92 of the AEP, should be amended by the introduction of something like a “Part 36 offer” procedure which would place the FRC at risk of costs if it rejected a proposed settlement figure.

- 15.2 This would, it is suggested, improve the prospects of early settlement and be much fairer. The present system, some respondents submitted, placed undue pressure on those in smaller firms to accept a discounted sanction due to concerns about escalating legal costs.
- 15.3 This suggestion is outwith the scope of the Review. We would, in any event, not be inclined to recommend it. The FRC, in conducting disciplinary investigations and enforcement proceedings, is not in the position of a civil litigant. We do not think it should have to pay costs if it has pursued allegations which a reasonable person could think it right to pursue.
- 15.4 More significant is the provision in paragraph 9(9) of the Schemes (not reflected in the AEP) which limits the power of a Disciplinary Tribunal to award costs to the situation where the Disciplinary Tribunal dismisses the Formal Complaint. As the Disciplinary Tribunal pointed out at paragraphs 357-8 of its report concerning the case of *Executive Counsel and (1) Stephen Harrison (2) PricewaterhouseCoopers LLP* this could give rise to real injustice if, for instance, 90% but not the whole of the Formal Complaint was dismissed and it was unreasonable to have pursued that portion. We agree with the observation of the Disciplinary Tribunal that the FRC should reconsider this.
- 15.5 We suggest that the FRC reconsider the terms of paragraph 9(9) of the Schemes.

16. Delay

- 16.1 Many respondents to the Call for Submissions expressed concerns about the time taken to complete the disciplinary procedure. Several impressed upon us the significantly deleterious effects on firms and, in particular, on individuals of the investigative and disciplinary process. In the case of audits, for instance, there may be a long interval between the completion of the audit and the commencement of an investigation, which may, itself, be prompted by an event, such as the discovery of some fraud or scandal, the collapse of a company or a restatement of financial statements, that occurs some considerable time after the relevant audit⁶⁰. The announcement of an investigation may give rise to severe reputational damage and paralyse the partner or individual(s) concerned in relation to audit work, since the fact that they are under investigation may easily be discernible as a result of the announcement of an investigation, or have to be revealed anyway; and they may well have to abstain from audit work, or audit work for particular clients, until the proceedings are over. Clients may disengage and potential new clients turn away in the light of publicised claims as well as reports of misconduct and sanctions.
- 16.2 To have an investigation hanging over one's head may inflict real suffering on individuals, both financial and emotional, the latter of which may increase excessively as time passes (slowly) by. If, at the end of the day, striking off, suspension or a fine is ordered, the individual concerned may have retired – so that the deterrent effect of any sanction in relation to him personally is minimal or non-existent. The fine on the firm may well, in the light of the delay, be borne, wholly or largely, by those who had nothing to do with the regulatory breach in question since those who were have now retired or left; and be levied in circumstances where the defects revealed by the investigation have long since been remedied by the firm itself (or because accepted standards have changed) and there is nothing left to deter.
- 16.3 We fully appreciate the stress that investigative and disciplinary proceedings place on individuals and entities in a context in which potential civil liability is itself something of a deterrent. That is to some extent an inevitable consequence of a professional disciplinary system. But any significant delay in the initiation and conclusion of disciplinary proceedings is highly prejudicial to the satisfactory working of the regulatory regime and has deleterious effects on individuals and firms.
- 16.4 It is not within the remit of our inquiry to determine the causes of delays or to make recommendations as to how delay might be reduced. We are aware that strenuous efforts have been, and are being, made to reduce the level of delay; that the position has changed dramatically in recent years; and that the number of long outstanding cases has substantially reduced. The current aim is that no more than two years (and preferably

⁶⁰ In the *MG Rover case*, which did not relate to audits, the Misconduct was said to have occurred in 2001 and 2002. The investigation was announced in **August 2005**. The Formal Complaint was made on **12 January 2012**. The full hearing took place from 5 - 28 March 2013. The decision was issued on **2 September 2013**. The Appeal Tribunal decisions are dated **28 January** and **25 March 2015**. In the case of *The Executive Counsel to the FRC and (1) PricewaterhouseCoopers LLP (2) Simon Bradburn* relating to Cattles Plc and Welcome Financial Services Ltd an investigation was announced in July 2009 and the latest settlement was in August 2016. Some of the later delay was attributable to concurrent civil litigation. In relation to the case of *The Executive Counsel to the FRC and (1) Stephen Harrison and (2) PricewaterhouseCoopers LLP*, the comparable dates were November 2010 and April 2017.

considerably less) should elapse between the start of an investigation and a Proposed Formal Complaint or Initial Investigation Report.

- 16.5 We are, however, asked to consider the fairness and effectiveness of the range of sanctions available. We have no hesitation in saying that substantial delay potentially affects the fairness of proceedings; limits the range and effectiveness of sanctions; prevents lessons from being timeously learned and acted upon (and audit quality thereby improved); and does nothing to promote, and may well reduce, public confidence in the profession and its regulation.

Recommendation 17

We recommend that as much as can possibly be done should be done to accelerate the process of initiation and resolution of disciplinary proceedings and that everyone concerned - at the FRC, in the Tribunals and in the profession - should do all that they can to reduce delay and accelerate resolution of such proceedings.

17. Conclusions and summary

- 17.1 Our conclusions on the matters we were asked to review are as follows.
- 17.2 The reasons for imposing sanctions as articulated in the Sanctions Guidance and the Sanctions Policy remain appropriate. But they are expressed in the wrong order by putting deterrence before the other three objectives. The order should be reversed and the objectives should also include the maintenance and enhancement of the quality and reliability of accountancy work/future audits and the promotion of public confidence in the regulation of the accountancy profession: **Recommendation 1** - page 8 above.
- 17.3 In general, but subject to the qualifications and recommendations which we make in this report, we regard the Sanctions Guidance and the Sanctions Policy as containing a fair and effective range of sanctions, and those documents as striking a balance, as one respondent put it between “*being excessively prescriptive ...and unhelpfully vague*”. We recognise, however, (a) that sanctions, and in particular fines have a limited role in promoting good behaviour; and (b) that fines greater than those that have heretofore been imposed may be appropriate in really serious cases.
- 17.4 We do not think it appropriate to recommend the use of some form of tariff, range or further guideline as to financial penalty; nor do we think that fairness requires it. We think it better to leave sanctions (both financial and non-financial) to the judgement of decision makers in the light of a set of principles and guidance. We have reached this conclusion because the complexities of the situations with which decision makers will have to deal and the need to do that which is just in each case – which is not a scientific exercise - militates against such an approach.
- 17.5 The Sanctions Guidance and the Sanctions Policy should contain a provision that where an individual has been found to have been dishonest the recommendation should normally be that he be excluded for at least 10 years: **Recommendation 8** – see page 40 above.
- 17.6 Greater attention should be given than has been the case in the past to the use of non-financial penalties: **Recommendation 7** – see page 39 above. A specific requirement should be added to the Sanctions Guidance and the Sanctions Policy to consider whether the sanctions proposed to be imposed would be likely to lead to improvements in the failings which gave rise to the proceedings and in the quality of work of the individual or firm concerned; and whether the objectives of the Sanctions Guidance and the Sanctions Policy could be achieved without a financial penalty or with a lesser financial penalty by the use of non-financial sanctions: **Recommendation 9** – see pages 41-42 above.
- 17.7 We make a number of recommendations in relation to the detailed provisions of the policy and guidance material, namely:
- (a) the omission of the requirement on decision makers to follow a specific format or order; or, in addition to specifying any financial sanction, to specify a range into which any fine might fall: **Recommendation 2** – see page 16 above;

- (b) the addition to the Sanctions Guidance and the Sanctions Policy of certain additional factors for consideration: **Recommendations 3 and 4** – see page 17 above;
- (c) the inclusion of a provision in the Sanctions Guidance and the Sanctions Policy that the existence of a previous sanction on an individual or firm will not automatically be regarded as a significant aggravating factor and that its significance should depend on a number of considerations: **Recommendation 5** – see page 18 above;
- (d) that the Sanctions Guidance should be amended so as to require decision makers to have due regard to the fact that sanctions have been or may be imposed by another regulator, just as the Sanctions Policy does: **Recommendation 6** – see page 38 above;
- (e) that the Sanctions Guidance and the Sanctions Policy should be amended so as (i) to provide a somewhat greater incentive to timely settlement; (ii) to remove any substantial discount for very late settlement; (iii) to specify that the discount should not be applicable to any part of the proposed penalty which equates to the disgorgement of a profit made or loss avoided or the repayment or waiver of a fee; (iv) to remove the requirement that a full discount should only be available on settlement if the Member/Member Firm or Statutory Auditor/Statutory Auditor firm admits substantially all the heads of complaint of the Formal Complaint or all the findings; (v) to provide that an appropriate level of discount should be allowed where the Member/Member Firm or Statutory Auditor/Statutory Auditor firm agrees the facts and liability but not the level of financial sanction or discount: **Recommendations 10 - 14** – see pages 49-51 above.

17.8 We have **not recommended** certain matters that we were invited to consider namely that the Sanctions Guidance and the Sanctions Policy should be amended so as:

- (a) to provide for a tariff, range or guideline along the lines of those of the SGC: see paragraph 4.2 above;
- (b) to provide some form of specific guidance as to whether there should be a Reprimand or a Severe Reprimand: see paragraph 8.13 above;
- (c) to preclude sanction, or any serious sanction, against an individual simply because he was not dishonest or lacking in integrity; or to encourage firmer sanctions against individuals: see paragraph 9.4 above;
- (d) to encourage Tribunals to require the payment of compensation – which is a matter for the civil courts – see paragraph 10.1 above;
- (e) to define what is meant by cooperation, although we do suggest that the FRC should consider whether further examples could be given in the Sanctions Guidance and the Sanctions Policy as to what “cooperation” may include: see paragraphs 12.2-12.3 above;

- (f) to introduce something like a Part 36 offer procedure in relation to costs, both because the issue is out of scope and because we do not agree with the suggestion – see paragraph 15.3 above. We do however suggest reconsideration by the FRC of paragraph 9(9) of the Schemes which limits the power of the Disciplinary Tribunal to award costs to the situation where it dismisses the Formal Complaint – see paragraph 15.5 above.
- 17.9 We recommend that the FRC should make available in one readily accessible place on its website decisions of tribunals and other decision makers, including settlement agreements, together with a summary of the cases including details of the respondent(s), the sanctions imposed and a summary of the Misconduct/breach of Relevant Requirements established indicating what went wrong: **Recommendation 15** – see page 54 above.
- 17.10 We recommend that the Sanctions Guidance and the Sanction Policy be amended so as to provide that decision makers should determine the sanction which they think appropriate on the facts and circumstances of the case before them and should not feel constrained by the sanctions imposed (or not imposed) in earlier cases to impose a sanction which they do not think appropriate: **Recommendation 16** – see page 56 above.
- 17.11 Lastly, but very importantly, we recommend that as much as can possibly be done should be done by all concerned to accelerate the process of initiation and resolution of disciplinary proceedings: **Recommendation 17** – see page 59 above.

Sir Christopher Clarke

Peter Chambers

Andrew Long

Enforcement Procedures Sanctions Review

Snapshot of the FRC's three principal enforcement procedures

<i>FRC Procedure</i>	<i>Regulated persons</i>	<i>Scope/Limitation of actionable conduct</i>	<i>Basic decision process</i>	<i>Source of regulatory power/jurisdiction</i>	<i>Available sanctions</i>
<p>Accountancy Scheme and Accountancy Regulations.</p> <p>See also Conduct Committee (“CC”) guidance documents including the Sanctions Guidance.</p> <p>The CC has oversight of the operation of the Accountancy Scheme.</p>	<p>Members / Member Firms of accountancy professional bodies participating in the Accountancy Scheme (“Participant(s)”¹) <u>other than Members/Member Firms, since 17 June 2016, in relation to statutory audit work, subject to various transitional arrangements in the Statutory Auditors and Third Country Auditors Regulations 2016 (“SATCAR 2016”)(see below).</u></p>	<p>Misconduct in public interest cases.</p> <p>In non-public interest cases any alleged wrongdoing / misconduct is investigated, heard and sanctioned by the relevant Participant themselves under their own rules, bye-laws and / or regulations.</p>	<p>1. CC decides whether paragraph 5(1) criteria are met and whether to investigate. Paragraph 5(1) criteria are:</p> <p><i><u>the matter raises or appears to raise important issues affecting the public interest in the UK; and</u></i></p> <p><i><u>there are reasonable grounds to suspect that there may have been Misconduct which means an act or omission or series of acts or omissions, by a Member or Member Firm in the course of his or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual), or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy</u></i></p>	<p>The Accountancy Scheme is a voluntary contractual arrangement with the Participants which was originally underpinned by the statutory requirements (pursuant to Part 42 of and paragraphs 16 and 24(1) of Schedule 10 to the Companies Act 2006) for recognised supervisory bodies (“RSBs”) to participate in arrangements for the independent investigation for disciplinary purposes of audit public interest cases.</p> <p>The contractual arrangement was extended to all the members of the accountancy professional bodies who are Participants by agreement with those bodies. The Accountancy Scheme operates independently of the Participants.</p> <p>Since the FRC became the competent authority on 17 June 2016, and introduced the Audit Enforcement Procedure, the</p>	<p>Members:</p> <p>Reprimand Severe Reprimand Condition Exclusion Fine Waiver / repayment of client fees Preclusion</p> <p>Member Firms:</p> <p>Reprimand Severe Reprimand Condition Fine Waiver / repayment of client fees Preclusion</p>

¹ The Participants are ACCA, CAI, CIMA, CIPFA, ICAEW, ICAS.

<i>FRC Procedure</i>	<i>Regulated persons</i>	<i>Scope/Limitation of actionable conduct</i>	<i>Basic decision process</i>	<i>Source of regulatory power/jurisdiction</i>	<i>Available sanctions</i>
			<p><i>profession, (paragraph 2(1) of the Accountancy Scheme)²</i></p> <p>or</p> <p><i>it appears that the Member or Member Firm has failed to comply with any of his or its obligations under paragraphs 14(1) or 14(2) [of the Accountancy Scheme].</i></p> <ol style="list-style-type: none"> 2. A matter may come to the CC's attention through a referral from a Participant or by 'calling in' a matter being investigated by a Participant or through some other means such as a press report / other regulator referral. 3. The Executive Counsel investigates and decides whether to close the investigation, enter into settlement discussions or deliver a Formal Complaint. 4. Independent tribunal hears the Formal Complaint and determines whether to reach an Adverse Finding and if so, whether to impose sanctions. 	Accountancy Scheme now ONLY applies in respect of non-statutory audit matters.	

² See R(oao Baker Tilly UK Audit LLP & Ors) v FRC & Ors [2015] EWHC 1398 (Admin) in respect of the meaning of "misconduct".

<i>FRC Procedure</i>	<i>Regulated persons</i>	<i>Scope/Limitation of actionable conduct</i>	<i>Basic decision process</i>	<i>Source of regulatory power/jurisdiction</i>	<i>Available sanctions</i>
<p>Actuarial Scheme and Actuarial Regulations.</p> <p>See also CC guidance documents including the Actuarial Scheme and the Actuarial Scheme Sanctions Guidance.</p> <p>The CC has oversight of the operation of the Actuarial Scheme.</p>	<p>Members of the Participants in the Actuarial Scheme - currently only the Institute and Faculty of Actuaries is a Participant.</p> <p>NOTE: there are no Member Firms.</p>	<p>Misconduct in public interest cases.</p> <p>In non-public interest cases any alleged wrongdoing / misconduct is investigated, heard and sanctioned by the relevant Participant themselves.</p>	<p>1. CC decides whether paragraph 5(1) criteria met and whether to investigate. Paragraph 5(1) criteria are:</p> <p><i><u>the matter raises or appears to raise important issues affecting the public interest in the UK; and there are reasonable grounds to suspect that there may have been Misconduct which means an act or omission or series of acts or omissions, by a Member in the course of his professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or has brought, or is likely to bring, discredit to the Member or to the actuarial profession, (paragraph 2(1) of the Actuarial Scheme)</u></i></p> <p>or</p> <p><i>it appears that the Member has failed to comply with any of his obligations under paragraphs 14(1) or 14(2) [of the Actuarial Scheme].</i></p>	<p>The Actuarial Scheme is a voluntary contractual arrangement with the Participants. No statutory underpinning.</p> <p>The Actuarial Scheme operates independently of the Participants.</p>	<p>Reprimand</p> <p>Severe Reprimand</p> <p>Condition</p> <p>Exclusion</p> <p>Fine</p> <p>Waiver / repayment of client fees</p> <p>Preclusion</p>

<i>FRC Procedure</i>	<i>Regulated persons</i>	<i>Scope/Limitation of actionable conduct</i>	<i>Basic decision process</i>	<i>Source of regulatory power/jurisdiction</i>	<i>Available sanctions</i>
			<p>2. A matter may come to the CC’s attention through a referral from a Participant or by ‘calling in’ a matter being investigated by a Participant or through some other means such as a press report / other regulator referral.</p> <p>3. The Executive Counsel investigates and decides whether to close, enter into settlement discussions or deliver a Formal Complaint.</p> <p>4. Independent tribunal hears the Formal Complaint and determines whether to reach an Adverse Finding and if so, whether to impose sanctions.</p>		
<p>Audit Enforcement Procedure (“AEP”).</p> <p>See also various CC guidance documents.</p>	<p>Statutory Auditors and Statutory Audit Firms (defined in rule 1 of the AEP).</p>	<p>Breach of Relevant Requirements³ where those matters are retained by the FRC.⁴</p> <p>All other audit matters are delegated to the Delegate Bodies</p>	<p>1. Case Examiner decides whether to refer an Allegation, (defined in rule 1 of the AEP <i>as information about a Statutory Auditor or Statutory Audit Firm which raises a question as to whether they have breached a Relevant Requirement</i>) to the CC.</p>	<p>Regulation (EU) No 537/2014 and Directive 2014/56/EU⁶ (“Audit Regulation and Directive” / “ARD”) and SATCAR 2016 which designates the FRC as competent authority for audit in the UK.</p>	<p>A notice to cease or abstain</p> <p>Publish a statement (which may take the form of a reprimand or severe reprimand) to the effect that the</p>

³ Defined in the AEP as having the meaning set out in regulation 5(11) of SATCAR 2016 or regulation 11(5)(b) of SATCAR 2016.

⁴ ‘Retained Matters’ include: (investigations and enforcement in respect of) audits of Public Interest Entities (“PIEs”) as defined in regulation 2 of SATCAR 2016, AIM companies with an average three year market capitalisation in excess of €200m, Lloyds Syndicates and investigations which the FRC may reclaim from the RSBs from time to time (“Reclaimed Matters”). See SATCAR 2016, the Secretary of State Direction under regulation 3(12) of SATCAR 2016 of 17 June 2016 and the Delegation Agreements between the FRC and the RSBs.

⁶ which amends EU Directive 2006/43/EC.

FRC Procedure	Regulated persons	Scope/Limitation of actionable conduct	Basic decision process	Source of regulatory power/jurisdiction	Available sanctions
		pursuant to SATCAR 2016 and Delegation Agreements with the Delegate Bodies. ⁵	<ol style="list-style-type: none"> 2. Where an Allegation is referred, the CC decides whether there is “good reason” to investigate the Allegation (see CC guidance for non-exhaustive list in this regard) and refers the Allegation for investigation by the Executive Counsel. The CC also decides whether the investigation should be delegated to the appropriate RSB and whether the investigation shall be overseen by the FRC’s Case Management Committee. 3. Allegation is investigated and Executive Counsel issues a Decision Notice if he considers that the Respondent is liable for Enforcement Action (<i>which means any steps taken pursuant to rules 17, 18, 24, 25, 27 and 54 of the AEP</i> (rule 1 AEP)) 4. If the Decision Notice is not accepted (i.e. no settlement) then the matter is referred to an Enforcement Committee. 5. The Enforcement Committee issues a Decision Notice if it 		<p>Respondent is required to cease or abstain</p> <p>Order the Respondent to take action to mitigate the effect or prevent the recurrence of the breach of Relevant Requirement</p> <p>Temporary prohibition of up to three years duration from carrying out Statutory Audits and / or signing audit reports</p> <p>Permanent prohibition from carrying out Statutory Audits and / or signing audit reports</p> <p>Declaration that the Statutory Audit Report does not satisfy the Relevant Requirements</p>

⁵ ACCA, CAI, ICAEW and ICAS.

<i>FRC Procedure</i>	<i>Regulated persons</i>	<i>Scope/Limitation of actionable conduct</i>	<i>Basic decision process</i>	<i>Source of regulatory power/jurisdiction</i>	<i>Available sanctions</i>
			<p>considers that the Respondent is liable for Enforcement Action.</p> <p>6. If the Decision Notice is not accepted then the matter is referred to an independent tribunal.</p>		<p>Waiver / repayment of client fees</p> <p>Temporary prohibition order for up to three years from being a member of the management body of a firm that is eligible for appointment as a statutory auditor</p> <p>Temporary prohibition order for up to three years from acting as a director of or being otherwise concerned in the management of a PIE</p> <p>Financial penalty</p> <p>Conditions</p> <p>Exclusion</p>