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

1 March 2013

Dear Ms Broom

Auditor Regulatory Sanctions Procedure

The Association of Chartered Certified Accountants (ACCA) is grateful for the opportunity to respond to the consultation paper concerning the proposed structure and content of the Auditor Regulatory Sanctions Procedure.

If there are any matters arising from the enclosed response that require further clarification, please do not hesitate to contact Sundeep Takwani, Director – Regulation (tel: 020 7059 5877, email: sundeep.takwani@accaglobal.com) or Ian Waters, Regulation and Standards Manager (tel: 020 7059 5992, email: ian.waters@accaglobal.com).

Yours sincerely

Sundeep Takwani
Director – Regulation

Auditor regulatory sanctions procedure

Comments from ACCA to the Financial Reporting Council
1 March 2013

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

We support our 154,000 members and 432,000 students in 170 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of over 80 offices and centres and more than 8,400 Approved Employers worldwide, who provide high standards of employee learning and development.

www.accaglobal.com

Further information about ACCA's comments on the matters discussed here can be sent to:

Sundeep Takwani
Director – Regulation
Email: sundeep.takwani@accaglobal.com

TECH-CDR-1199

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

ACCA welcomes the opportunity to comment on the consultation paper and draft Procedure issued by the Financial Reporting Council (FRC).

GENERAL COMMENTS

We have, in the past, supported the move towards appropriate regulatory independence of the FRC, which we perceive as vital to underpin confidence in the accountancy profession. As stated in January 2012, 'we agree with the proposal that, under certain circumstances, the FRC should be able to require an RSB to impose proportionate sanctions, provided clear procedures are published by the FRC'.

Nevertheless, it is essential to respect the right to a fair hearing prior to sanctions being determined. In addition, ACCA has previously expressed uneasiness about receiving directions from the FRC on how to discipline its members in situations in which ACCA had not been a party to the investigation or the determination of the sanction. Most importantly, the sanction may not be in line with current ACCA policy or practice.

We have set out below our specific concerns regarding the clarity, completeness and fairness of the draft Procedure. We acknowledge that there are not expected to be a high number of Audit Quality Review (AQR) inspections to ACCA firms. However, we would like to point out that paragraph 1.2 of the background to the consultation paper does not relate to ACCA. ACCA's Admissions and Licensing Committee comprises a lay majority, and is constituted from a panel appointed by a Sub-committee of ACCA's Regulatory Board. The Regulatory Board itself has a lay majority, and further information concerning ACCA's regulatory oversight arrangements may be found at www.accaglobal.com/en/member/professional-standards/regulatory-board.html.

SPECIFIC COMMENTS

Question 1: Do you consider the proposed Procedure to be understandable?

Generally, we believe that the Procedure could be made significantly more understandable. For example:

i. Every attempt should be made to avoid vagueness in the Procedure. An example of this appears in paragraph 4.1(a), which refers to a Registered Auditor's continued registration adversely affecting a major audit client or 'any other person'.

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

ii. It may be possible to enhance clarity though greater consistency and clarity of language and terminology. It appears that the draft Procedure intends to set out how a sanction may be determined by the Monitoring Committee – with the consent of the Registered Auditor – or by the Independent Sanctions Tribunal (IST) – without such consent – and that the RSB is directed to impose the sanction on its member. The word 'determine' appears in paragraphs 2.1 (interpretation of 'regulatory penalty'), 8.1, 12.9(a) and 12.9(c). However, the draft Procedure refers to sanctions being 'ordered' by the IST in paragraphs 12.5, 12.6, 12.8, 12.11 and 19.1. We propose that 'determined' is, in fact, the appropriate word to be used throughout.

iii. The procedures relating to publicity could be brought together in a single section. Currently, the draft Procedure refers to the publishing of sanctions in sections 7.4 (where a sanction has been agreed with the Monitoring Committee) and 12.9 (where a sanction has been determined by the IST).

iv. It is not clear why sanctions determined by the IST are to be published by the Monitoring Committee.

v. It is unclear what affect the different procedures of the various RSBs would have in practice, and paragraph 1.4 of the background information in the consultation paper would suggest that ACCA has not been considered along with ICAEW, ICAS and Chartered Accountants Ireland in this respect. One such inconsistency in procedures might relate to the recovery of fines and costs. ACCA, for example, would exclude someone from membership for the non-payment of any debt to ACCA. What will the FRC do if costs ordered (or directed) are not paid to the FRC?

vi. The Procedure must make clear that it relates to United Kingdom audit clients only. We understand that reference to the RI 1990 Act is relevant to the precise definition of an RSB and the understanding of 'Registered Auditor'. However, the work of the Conduct Committee does not extend to Registered Auditors and audit entities in the Republic of Ireland, and so it would be preferable to define these terms in the context of the Auditor Regulatory Sanctions Procedure.

Question 2: Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to the Procedure?

Yes, we agree that the draft Procedure would provide enhanced protection to the public, while setting out a fair process for those subject to the Procedure

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

(subject to our comments under Question 4 below). However, greater clarity is required in the document in order to demonstrate this balance.

Question 3: Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

Yes. The following are worthy of further consideration:

i. What procedure will take place if undertakings given by a Registered Auditor are not honoured?

ii. The procedure does not set out the repercussions of non-compliance with an order imposed by an RSB in each case. It appears that any sanction determined by the Monitoring Committee or the IST will result in a direction to the relevant RSB to impose the sanction. If that RSB fails to recover a regulatory penalty, or a Registered Auditor fails to comply with restrictions or conditions imposed on its registration, what intervention by the FRC would be appropriate?

iii. Is there a maximum fine that may be determined by the Monitoring Committee or the IST?

iv. Paragraph 12.5(a) of the draft Procedure states that the IST may determine such sanction 'as it considers appropriate'. There is no reference to any sanctions guidance criteria. Similarly, there is no indication of how the Monitoring Committee may determine that a particular sanction is appropriate.

v. Paragraph 14.2(e) states that an accountant serving on the IST must be 'a Member of a professional accountancy body whether or not that body is an RSB'. We note that 'professional accountancy body' is not defined, although we assume that this should not include a body whose members are not qualified to conduct audits (for example a professional body of bookkeepers).

vi. Paragraph 17 of the draft Procedure is entitled 'Postponement and Adjournment'. However, its provisions only relate to postponement, and not adjournment. (Paragraph 17.2 refers to neither postponement nor adjournment.)

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

Question 4: Do you have any other comments about the proposed Procedure?

We should like to raise the following comments:

i. Paragraph 12.3 of the draft Procedure appears unreasonable. We would be interested to know why the FRC considers evidence that would not be admissible in a court appropriate for consideration by the IST when coming to its decision. We believe that the FRC should place greater importance on fairness and openness when redrafting the Auditor Regulatory Sanctions Procedure.

ii. According to paragraph 14.2(f) of the draft Procedure, former members of the governing bodies and former officers and employees of the RSBs may be appointed to the IST after a 'cooling off' period of one year. This period seems brief, and the rationale has not been explained. ACCA requires a period of three years before a former employee or Council member may serve on its regulatory or disciplinary Committees, and in the case of auditor independence and employment relationships (according to Ethical Standard 2 Financial, Business, Employment and Personal Relationships), the relevant period is two years.

iii. Paragraph 4.2 of the draft Provision lists 'Suspension of Registration' among the available sanctions, but paragraph 4.3 explains that, during a period of suspension, a Registered Auditor may continue to act as auditor for existing clients. The latter paragraph requires detailed review and revision. In our opinion, a recipient of the publicity concerning such a sanction would not consider the conditions in paragraph 4.3 to amount to a suspension.

The only proposed restrictions for the suspended auditor firm are that it may not accept any new appointments and that it may only 'sign' audit reports with the permission of the Monitoring Committee. We should like clarity concerning whether these restrictions will apply only in respect of major audit clients. Furthermore, it is unclear in what circumstances a Registered Auditor would be permitted to act as auditor but denied permission by the Monitoring Committee to sign the audit report.

iv. We note that withdrawal of registration is also an available sanction. While this would usually be a sanction favoured by ACCA (requiring reapplication when appropriate), we would expect this sanction to be determined rarely under the Auditor Regulatory Sanctions Procedure, as it would require the Registered Auditor to resign from *all* audits, and not just those of public interest entities.

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

v. We note that all meetings and hearings are to be conducted in private, and we have considered the appropriateness of this in view of the fact that they will often concern public interest entities. While it may be asserted that this is not best practice, sanctions are to be considered against the Registered Auditor, rather than the audit client, and there will often be a strong argument in favour of protecting the identity of the client.

Counter to this is the argument that supports the regulatory principle of transparency. A hearing of the IST will take place when the Monitoring Committee has failed to agree a sanction with the Registered Auditor and, therefore, the circumstances of the hearing would be expected to be somewhat contentious. Under such conditions, the FRC would wish to avoid criticism that sanctions were being 'agreed behind closed doors'.

These two opposing views illustrate the challenge that remains for the FRC concerning whether or not it is in the public interest for hearings of the IST to take place in private.

vi. Paragraph 2.3 of the outline of the proposed Procedure states that AQR staff may attend meetings of the Monitoring Committee, although Registered Auditors may not attend. This does not appear to be reflected in paragraph 13.2 of the proposed Procedure, which states that the meetings may be attended by anyone for the purpose of advising the Monitoring Committee on its 'duties, powers or procedures and the law' or by 'any other person permitted by the Monitoring Committee'. In any case, in our opinion, the imbalance suggested by paragraph 2.3 of the outline is unacceptable, both in practice and appearance.

vii. Paragraph 10.1 refers to the appointment of an IST in accordance with paragraph 17, although the relevant provisions for appointment of an IST are, in fact, within paragraph 14.

CONCLUSION

While ACCA supports the enhanced regulatory independence of the FRC demonstrated by the development of the Auditor Regulatory Sanctions Procedure, we suggest that the concerns expressed above require careful consideration by the FRC, in order to enhance the clarity of the Procedure, and demonstrate due regard for the principles of justice and better regulation.

29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

www.accaglobal.com

BDO

Tel: +44 (0)20 7486 5888
Fax: +44 (0)20 7487 3686
DX 9025 West End W1
www.bdo.co.uk

55 Baker Street
London W1U 7EU

Sophie Broom
Communications Executive
Financial Reporting Council
5th Floor
Aldwych House
71-91 Aldwych
London
WC2B 4HN

1 March 2013

Our ref: 000/DI/NG

Email: iain.lowson@bdo.co.uk

Dear Sophie

Consultation Draft: Auditor Regulatory Sanctions Procedure

We welcome the opportunity to comment on the above consultation. BDO is an award winning UK member firm of BDO International, the world's fifth largest accountancy network, with more than 1,000 offices in more than 100 countries.

We address your four questions below.

Question 1: Do you consider the proposed Procedure to be understandable?

We appreciate the rationale for the proposed changes to the regulatory sanctions procedure, namely to give greater independence (and therefore integrity) to the review process.

However, in the areas specifically highlighted below (in particular, in our responses to questions 2 and 3), we consider that the Procedure could benefit from greater clarification and guidance, notably i) who comprises the Monitoring Committee; ii) who can be sanctioned; iii) what breaches will be sanctioned and iv) what penalties can be imposed.

Question 2: Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to the Procedure?

There could be greater clarity as to what will amount to a breach capable of sanction. Paragraph 2.2 of the Procedure states that sanctions will apply to 'poor quality audit work' only. In spite of this, we are uncertain as to whether it may have been intended for this to extend to certain types of misconduct. Whilst the final paragraph of 2.3 of the Procedure suggests that instances of misconduct will be referred to the Conduct Committee (and therefore be investigated and, potentially, sanctioned via another route), the second paragraph of 2.3 states that the Monitoring Committee will consider 'whether the AQR's reports indicate that there has been a material failure to comply with the Regulatory Framework for Auditing' (emphasis added). This could suggest a broader range of misconduct than simply poor quality audit work.

The situation is, in our view, further complicated by the fact that the term 'poor quality audit work' itself is open to some confusion or misunderstanding. It appears to cover a very broad spectrum of potential breaches, with the only frame of reference being that continued registration "could adversely affect a Major Audit Client or any other person" or it is necessary to impose a sanction to "ensure that their Statutory Audit Functions are undertaken, supervised and managed effectively". Some guidance as to specific examples of breaches which could be

sanctioned may add some useful clarity. This will also encourage transparency, thus achieving a greater balance between fairness and protection of the public.

In addition, fairness may be better served if there was greater clarity regarding the penalties which can be imposed relative to the severity of the breach. Paragraph 4.2 of the Proposed Procedure details the sanctions to which a Registered Auditor can be liable; however, in our view further detail could be usefully provided here. First there is no definition of "Restrictions" or "Conditions". Secondly we feel it would be useful, as with the ICAEW (Guidance on Sentencing), for similar guidelines to be issued. The process of imposing penalties and other sanctions is, therefore, transparent and firms are aware of what they could be facing from the earliest opportunity. Such guidance could also act as a deterrent, for other firms, to avoid the same issues.

Finally, with a view to fairness, we note that Paragraph 4.3 of the Proposed Procedure (which sets out the actions that a registered auditor may perform during the period of suspension) may have a bias against smaller firms (who may, even still, have clients falling under AQR scope) as the imposition of sanction (d) would have a detrimental effect on their business (potentially over and above the severity of the sanctionable breach). With regard to the top 10 audit firms, such a sanction is likely to be entirely impractical and unworkable given the sheer volume of reports they sign for Major Audit Clients. For this reason, the FRC may wish to consider whether this sanction is, indeed, workable for a firm of any size.

Question 3: Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

In our view it would be useful for the Procedure to set out the makeup of the Monitoring Committee. Whilst the consultation paper sets out the makeup of the Independent Sanctions Tribunal (however see our point noted below), it does not set out, at all, who may be a member of the Monitoring Committee. It simply states that the individuals will be appointed by the FRC's Conduct Committee. Given that the Monitoring Committee will make decisions about sanctions to be imposed on Regulated Auditors and the primary objective of the revised Procedure is to improve independence, it is essential that this body is independent and able to make objective recommendations. Its composition therefore requires transparency.

Further, we note that the IST may comprise of either 'three or five persons'. Paragraph 14.2 of the Proposed Procedure details that the number sitting on the Tribunal board will depend on what the Conduct Committee, in their absolute discretion, sees fit. To assist transparency, it would be useful if some guidance could, nonetheless, be given as to when a three person Board may be established and when a five member Board. Presumably this may depend on either the severity or complexity of the issue being discussed but it would be helpful if the FRC could clarify the position.

Finally, we note that the makeup of the Independent Sanctions Tribunal is to include an accountant (Proposed Procedure, paragraph 14.2c). However the only condition is that they are a member of a recognised professional body. Given the technical nature of the majority of the issues likely to be discussed by the IST we wonder if it may be more appropriate to appoint, on each occasion, an auditor. We would ask the FRC to consider whether an accountant who was not an audit specialist, would necessarily have the knowledge to give an expert opinion on the relevant audit issues.

Question 4: Do you have any other comments about the proposed Procedure?

We have no additional comments on the Procedure and hope that the comments we have raised above will be considered by the FRC to ensure an independent, fair Tribunal system which the public can have confidence in.

If you have any queries in relation to our above response, please contact Iain Lowson on 020 7893 3623.

Yours sincerely

BDO LLP

Deloitte

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

1 March 2013

Our ref. IJ/SA/HH2

BY EMAIL

Dear Ms Broom

Financial Reporting Council – Auditor Regulatory Sanctions Procedure

Deloitte is pleased to provide a response to the FRC's Consultation Paper on the proposed auditor regulatory sanctions procedure ("Procedure").

Although we do not intend to respond to your specific questions, we have set out our general comments below for your consideration.

The rationale for change is essentially that, whilst the current Recognised Supervisory Body ("RSB") process is working effectively, and there have been no instances of the relevant RSB committees overruling recommendations by the Audit Quality Review ("AQR") team, there may be a perception that the current process lacks independence. We understand that this perception arises primarily because the relevant RSB committees tend to be staffed by partners and staff from Member Firms who may be subject to the AQR process (of course, no individual member of a committee would participate in a discussion of a matter concerning their own firm). We agree that the current process works well, but we also recognise the perception (although we do not believe it to be reality) that the process may lack the necessary degree of independence. Accordingly, we are supportive of a process whereby the relevant RSB committee's role is effectively performed by the FRC.

However, we do not see any need, or indeed justification, for extending the jurisdiction or sanctioning powers of the FRC beyond that of the relevant RSB committee. Our primary concern with the current proposal is that it could be, albeit wrongly, interpreted as seeking to do just that. Whilst in the Consultation Paper there is an express recognition that the Procedure is not concerned with misconduct, and it is not, and should not be confused with, a disciplinary procedure or scheme, that is not readily apparent from the proposed Procedure rules themselves. We think it would be helpful if these recognised points were to be expressly reflected in the Procedure rules.

It will also be important to ensure that any sanctioning guidance (on which we anticipate there will be a consultation in due course) does not seek to introduce, or suggest the imposition of, disciplinary type sanctions. Given that the Procedure is not concerned with misconduct and is not disciplinary in nature and given the rationale for the introduction of the Procedure (being the perceived lack of independence but not effectiveness, of the current RSB committee process), we would anticipate that the basis for the imposition of sanctions under the Procedure would mirror the basis currently used by the relevant RSB committee. In this regard it is notable that those sanctions are primarily aimed at introducing structural changes to the way in which a firm undertakes its audit services, such as requirement for there to be hot reviews, cold file reviews and conditions on registration. That range of sanctions is entirely consistent with the liability to a sanction which arises under the Procedure, which is aimed very much at such structural issues. It is not, and it should not become, a Procedure for introducing disciplinary type fines and other sanctions for audit work, which is a jurisdiction reserved to the Accountancy Scheme (or the relevant RSB's disciplinary process). Consistent with this approach, the ICAEW's rules make it clear that a regulatory penalty (the only financial sanction) is limited to consistent failures of a more administrative nature relating to the affairs of the firm, such as consistent late filing of annual returns, and not for the audit work itself. In other words, if the AQR happens to disagree with a firm's audit judgement and decides that the audit needed improvement (or significant improvement), absent misconduct, that is not a basis for a regulatory penalty. If this were the basis for a regulatory penalty, the relevant standard would be unclear because the requisite degree of non-compliance of the auditor's work is not defined (unlike in the context of a misconduct charge). A difference of opinion regarding the firm's audit judgement almost certainly could not be the basis for a regulatory penalty, because the necessity of such a sanction is highly unlikely to satisfy the requirements of clause 4.1.

On a practical note, we consider that it would assist for clauses 12.4 and 12.5 to be clarified so that it is clear that there must be consideration of the criteria of clause 4.1.

It might be that the above points are more readily addressed in the guidance under the Procedure which is proposed to be released (we assume the guidance would incorporate provisions regarding sanctions). Nevertheless, we think it would be helpful for these points to be expressly recognised in the Procedure.

We would welcome the opportunity to discuss this response to the Consultation Paper in more detail. Should you have any comments or questions please do not hesitate to contact Ian Joslin (ijoslin@deloitte.co.uk / 020 7007 0306).

Yours faithfully

Deloitte LLP

Grant Thornton

An instinct for growth™

Our Ref PMR

Sophie Broom
Financial Reporting Council
5th Floor, Aldwych House
79-91 Aldwych
LONDON
WC2B 4HN

National Office

Grant Thornton UK LLP
Grant Thornton House
Melton Street
London NW1 2EP

T +44 (0)20 7383 5100
F +44 (0)20 7383 4715
DX 2100 EUSTON
www.grant-thornton.co.uk

1 March 2013

Dear Ms Broom

Consultation Document: Auditor Regulatory Sanctions Procedure

We welcome the FRC's consultation paper and the opportunity to respond to it.

While we are in broad agreement with the proposed Procedure there are a number of areas where, in our opinion, significant improvements should be made to enhance the fairness and clarity of the Procedure. These are addressed in our response to the specific questions which follow in the appendix to this letter.

Yours sincerely

Peter Rowley
Director
For Grant Thornton UK LLP

T 0207 728 2725
E peter.m.rowley@uk.gt.com

Enc

Appendix: Response to Specific Questions

1. Do you consider the proposed Procedure to be understandable?

Yes.

2. Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to Procedure?

We believe that there are two areas where improvements are required to enhance the fairness of the Procedure. These relate to the notification process and publication of Sanctions and Independent Sanctions Tribunal (IST) notices.

Notification process

It is proposed that the Monitoring Committee (MC) will notify a member's or firm's Recognised Supervisory Board (RSB) at every stage of the process. This could result in the RSB being notified when:

- a matter has been reported to the MC but it has decided immediately to take no further action,
- when it proposes a sanction and issues a notice to the Registered Auditor; even though the MC could subsequently decide to take no further action, amend the sanction or accept a written undertaking from the Registered Auditor; in which event the MC will then again inform the RSB,
- if a matter is to be referred to IST,
- the report of the IST (whether or not confirming the MC's proposed sanction) is sent to the RSB.

In our view, the frequency of these notifications may cause damage to the standing of an RI or firm in the view of the Audit Registration Committee (ARC) whilst a matter is passing through the Procedure and there is still the possibility that a sanction will not be imposed. Therefore, we believe that the FRC should consider amending the Procedure so that the RSB will only be notified if a Sanction has been finally determined, either by the MC or IST.

Publication of Sanctions and IST notices

For an MC sanction, the Procedure will require the MC to publish details of the sanction "as soon as practicable and in such manner as it thinks fit unless this would not, in the opinion of the Monitoring Committee, be in the public interest". Similarly, where a Sanction is determined by the IST the MC is required to publish details unless the MC believes it would not be in the public interest to do so.

We are concerned that when the MC is considering publication of a Sanction, it will only need to be satisfied that publication is not precluded by the public interest rather than have to conclude that publication is in the public interest, which is the fairer test. Therefore, we believe that FRC should consider amending the Procedure so that the MC only reports Sanctions publicly when it concludes that to do so is in the public interest.

3. Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

See our response to Question 2.

4. Do you have any other comments about the proposed Procedure?

Scope of the procedure under paragraph 4.1

It is not clear to us why paragraph 4.1 (a) sets the scope of possible sanctions to include "continued registration ……affect a Major Audit Client or any other person" [emphasis added] as it extends beyond the public interest. As the term "any other person" is not defined, it is apparently totally unconstrained. If that is what is intended, the same scope could be achieved merely by stating ""continued registration ……affect any person".

Scope of paragraph 5.1

The scope of paragraph 5.1 is not consistent with the scope of paragraph 4.1 as a result of the inclusion of paragraph 5.1(a). In particular, the "test" in paragraph 5.1 (a) does not require either the AQR or the MC to be satisfied that a Registered Auditor "has failed to comply" with the Regulatory Framework for Auditing but, instead, merely that they "may have failed to comply". Also, there is no requirement that the criteria in paragraph 4.1 "may be satisfied".

As a result, under paragraph 5.1 Registered Auditors may need to incur the time and cost of making written representations in relation to matters that have no prospect of passing the tests in paragraph 5.2 or 5.4.

We therefore believe that the FRC should delete paragraph 5.1(a).

HERBERT
SMITH
FREEHILLS

Communications Executive
Financial Reporting Council
5th Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

For the attention of Sophie Broom

Herbert Smith Freehills LLP
Exchange House
Primrose Street
London EC2A 2EG
T +44 (0)20 7374 8000
F +44 (0)20 7374 0888
DX28
E stephen.flaherty@hsf.com
www.herbertsmithfreehills.com

Our ref
2337/2082/30929482
Your ref

Date
01 March 2013

By email and by post
(communications@frc.org.uk)

Dear Sirs

FRC Consultation Paper - Auditor Regulatory Sanctions Procedure (21 December 2012)

Thank you for the opportunity to respond to the Consultation Paper. We set out below our comments on the proposed Auditor Regulatory Sanctions Procedure (the "Procedure"). We do this by reference to certain paragraphs within the Procedure, rather than by specific reference to the consultation questions as we considered this to be the most logical way in which to provide our comments.

We act for clients that are regulated by the FRC on a regular basis. We make a number of observations that we consider will be of relevance to firms who will be subject to the Procedure. However, we are not submitting our comments on behalf of any particular clients.

Paragraph 3.1(i) of the Procedure states that the Conduct Committee has power to provide the Monitoring Committee, the Convener and any Independent Sanctions Tribunal ("IST") with guidance concerning the exercise of their duties under the Procedure and that the Monitoring Committee, the Convener and any IST shall have regard to such guidance. However, we note that the Consultation Paper does not contain any indication of the sorts of matters upon which it is envisaged that such guidance could be issued. We consider that any guidance which would have any material impact on the rights of firms who are subject to the Procedure should be the subject of appropriate consultation prior to being provided by the Conduct Committee. We would, therefore, encourage the Conduct Committee to disclose the specific areas which are presently being contemplated as being the subject of guidance in order that there is an opportunity for informed debate. We consider it would have been preferable to have included the guidance in this consultation in order to provide the full picture.

Paragraph 5.1(a) of the Procedure refers to the AQR including recommendations for sanctions as part of their proposed report to the Monitoring Committee. We consider that matters as to

appropriate sanctions should be for the Monitoring Committee and/or the IST to determine and that the AQR reports should be confined to the particular respects in which they consider there has been a failure to comply with the Regulatory Framework for Auditing. There is a risk otherwise that the process of monitoring and sanctioning are confused and due process is under-mined. We note the list of Sanctions set out in paragraph 4.2 of the Procedure. Does the FRC intend to publish guidance to the Monitoring Committee/IST in respect of the imposition of sanctions?

Paragraph 5.1 of the Procedure does not provide that the AQR's notification to the Registered Auditor should set out clearly the areas of the AQR's concerns so that the Registered Auditor is in a position to understand, at that stage, the particular matters in respect of which criticism is being levelled. We consider the Procedure should be amended to provide for this. We consider the AQR's report to the Monitoring Committee should be disclosed to the Registered Auditor so that the Registered Auditor is aware of the full extent of the criticisms which have been made against it. Otherwise, we consider there is the potential for procedural unfairness if the Monitoring Committee/IST are considering criticisms or information to which the Registered Auditor is not privy.

For the same reason we consider the Registered Auditor should also be provided with any "further information" to which reference is made in paragraph 5.5 of the Procedure. Unless provision is made for this there is a risk that such information will form part of the Monitoring Committee's assessment of the position but the Registered Auditor will not be aware of those facts and matters and will, therefore, be unable to address them when seeking to either defend or explain its conduct.

The time limit of 14 days for the Registered Auditor to respond to the Monitoring Committee referred to in paragraph 5.1 is not the subject of any possible extension. We consider that the Procedure should make some provision for these time periods being the subject of extension. We anticipate that in the case of many major audits 14 days would be a relatively short period of time in which to respond to criticisms. This is obviously important in circumstances where those criticisms have the potential to result in sanctions being imposed on the Registered Auditor.

Insofar as the arrangements concerning the IST are concerned, we understand from paragraph 14.6 of the Procedure that the FRC will act as complainant. However, the Procedure does not:

- set out how the FRC's case will be documented/presented or the stage at which notice of the FRC's case will be provided to the Registered Auditor;
- specify what documentation should be provided to the IST by the FRC, as Complainant, nor does it require that this material must also be provided to the Registered Auditor;
- identify who the Secretary to the IST will be or the basis on which they are appointed.

It may be that these matters are intended to be dealt with more fully in the guidance which we understand the Conduct Committee intends to provide. As mentioned above, we consider that given the importance of some of these aspects it would be appropriate for the draft guidance to have been issued in conjunction with this consultation. In any event we consider the Procedure should clarify the basis on which the FRC is required to present its criticism and ensure that the Registered Auditor has the same information as the IST. It is important that the Registered Auditor knows the detailed case which it must meet well in advance of any IST hearing.

While we acknowledge that it would, only in exceptional cases, be appropriate for a costs order to be made against the FRC, we consider that the jurisdiction given to the IST should be sufficiently wide to enable such an order to be made in such exceptional cases.

It is not clear from paragraph 14.1 of the Procedure whether the Committee to be appointed by the Nominations Committee is intended to be made up of Non-Conduct Committee members of the FRC, persons external to the FRC or a combination of both. In view of the nature of the matters which are likely to be in issue in any hearings before the IST we consider it would be a distinct advantage if the accountant member of the IST had a background in auditing.

In view of the potential severity of the sanctions which are available to the IST we consider that it would be appropriate to put in place a mechanism for appeals from the IST. We would suggest that an appeal mechanism similar to that which currently applies in respect of the Scheme would be appropriate.

Our understanding is that the FRC would, in appropriate circumstances, wish to be able to investigate a Registered Auditor under the Scheme for potential professional misconduct while at the same time considering whether a sanction should be made in accordance with the terms of the Procedure. Paragraph 13(b)(ii) of paragraph 10 of Schedule 10, Companies Act 2006 suggests that a sanction imposed under the Procedure shall be treated as if it were a sanction of the relevant supervisory body. We would query whether there is a possibility, under paragraph 5(2) of the Scheme, for an investigation under the Procedure to need to be suspended unless the position is subject to further clarification. We would in any event suggest that, in circumstances where following a referral from the Monitoring Committee under paragraph 5.5, the Conduct Committee pursues an investigation into potential professional misconduct against the Registered Auditor it would be appropriate to stay the Procedure.

In addition to the points mentioned above, we refer below to some minor suggested amendments:

We think paragraph 2.2 of the Procedure should read "Words and expressions have the meanings given in the 2006 Act and the ...".

Paragraph 5.6 of the Procedure should be amended to state "... from the AQR and/or the Registered Auditor".

For the avoidance of any possible doubt you might wish to consider amending the definition of "Firm" in paragraph 2.1 of the Procedure to:

> "(b) a partnership, including a limited liability partnership which engages in the performance of accountancy".

If you have any queries about our comments, please contact Stephen Flaherty on 020 7466 2082.

Yours faithfully

Herbert Smith Freehills LLP

1 March 2013

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

Dear Sophie

Public Consultation on FRC's Draft Regulatory Sanctions Procedure

ICAEW welcomes the opportunity to comment on the consultation paper the *Auditor Regulatory Sanctions Procedure* published by the Financial Reporting Council (FRC) on 21 December 2012, a copy of which is available from this link.

ICAEW has been in regular contact with the FRC regarding these procedures prior to their issue as a consultation document and most issues of substance have been addressed in this latest draft. Accordingly the attached comments are matter of refinement rather than substantial change.

We would question the proposed implementation date of 1 May 2013 for the procedure. The audit regulations of the RSBs need to be amended to align with these procedures, and the governance steps within those bodies to effect these changes can take between 2 to 3 months. These cannot be initiated properly until the finalised procedures document is issued which we surmise is unlikely to happen before the end of March. We would suggest that if the FRC wish the audit regulations and auditor regulatory sanction procedure to commence concurrently, a 1 July start date may be a more realistic date for commencement.

Yours sincerely

Vernon Soare

Vernon Soare
Director Professional Services

T +44 (0)20 7920 8787
F +44 (0)20 7920 0547
E Vernon.Soare@icaew.com

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

APPENDIX

Feedback on the consultation paper

1.3 It is stated that the "... Procedure relates only to poor quality audit work..." but there are other circumstances where it may be appropriate for FRC to issue a regulatory penalty e.g. signature of an audit report by a person who is not a Responsible Individual or where certain inappropriate financial interests are held by principals in firms.

1.3 It is stated "The procedure should not therefore be confused with any disciplinary procedures or schemes". Since it is intended to impose regulatory penalties (which are disciplinary in nature) and not deal simply with removal of registration or the imposition of restrictions/conditions there is a disciplinary element. If there is a matter which will require investigation under the FRC disciplinary scheme use of a regulatory penalty would not be appropriate. If a regulatory penalty were to be used firms would be able to argue that they should be able to treat the matter as concluded and not have to respond to an investigation under a Disciplinary Scheme.

2.1 This paragraph refers to the "offer of a proposed sanction". In some instances immediate action of a regulatory nature will be needed and so the concept of making an offer and inviting acceptance may not be appropriate. If, for example urgent withdrawal of registration were to be necessary that should be dealt with immediately.

2.1 Under ICAEW arrangements firms are able to challenge regulatory action before both the Review and the Appeal Committees. We draw attention to this not because we think there should necessarily be opportunity for a second hearing but so that any decision to adopt a different approach is taken consciously.

2.2 This paragraph includes a specific reference to a regulatory penalty being a fine. There seems to be a contradiction between this paragraph and paragraph 1.3 which says "The procedure should not therefore be confused with any disciplinary procedures...". From the inception of regulatory penalties we have stated explicitly that they are disciplinary in nature.

2.3 Paragraph 4 – This provides "The Monitoring Committee (MC) may refer a matter to the IST where it does not accept the undertakings provided by the registered auditor. As we understand the proposal it would be for the MC to propose the giving of undertakings and so it seems a bit odd to refer to it being unwilling to accept undertakings provided by the registered auditor. It may be that the author is alluding to the possibility that the MC, having offered an undertaking, the registered auditor provides an alternative formulation of it which the MC considers unacceptable.

2.3 Paragraph 5 – As indicated above if it is considered that there has been misconduct of any sort which requires investigation the MC should not impose a regulatory penalty but confine itself to conditions and restrictions etc.

2.4 Paragraph 1 – The issue of who is a "lay" member requires clear definition.

2.4 Paragraph 3 – As previously indicated, in the context of the FRC Disciplinary Scheme, to say "no abstentions permitted" seems unwise. It creates the possibility of lengthy proceedings being treated as a nullity if a member of the IST is determined to abstain despite the provision in the rules. This may seem a remote possibility but it is best avoided. In the event of equality of votes the Chairman should have a second vote.

3. Preliminary Impact Assessment – It is stated that "The impact assessment concluded that there was not expected to be any additional cost or significant transitional costs associated with these powers." It is not clear on what basis this conclusion was reached. What is being established is a new and parallel arrangement to that which exists already. It seems to us that there will inevitably be additional costs which will have to be met through the Audit Registration fees. No corresponding savings could be made in connection with the administration of the Audit Registration Committee which will continue to deal with the overwhelming majority of cases.

Feedback on the procedures – Annex B

Clause 2.1	Although a change to the proposed definition of "regulatory penalty" may be inappropriate it may be helpful to emphasise that a fine should be imposed on the registered firm, not on an individual.
Clause 4.4	As an RSB we consider that our role will be to record the decision in the same way we would if we had been the body responsible for taking it. We will then take reasonable steps to recover any regulatory penalty.
Clause 4.4	We consider that once a decision has been taken by the FRC and all of its processes have been exhausted any fresh application by a firm for registration following removal of registration, or lifting of a restriction or condition would have to be considered by us independently. It would obviously be sensible for us to consult FRC if an application was made and invite any representations, but it appears to us that as a matter of law the ultimate decision would have to be ours alone. This approach would be consistent with the regime in the Companies Act. If AQR chooses to make a fresh visit and report it may be that the matter could be dealt with via the FRC procedure as before.
Clause 8.1	See comments in relation to Clause 4.4 above.
Clause 5.1(a)	As we understand the process it is that the AQR will prepare a report and invites a firm's representations. If representations are received it is possible that the report will be amended to reflect comments made. Accordingly, in 5.1(a) to describe it as a "proposed report" suggests AQR has only reached a provisional view. Deletion of "proposed" would seem appropriate.
Clause 5.5	In the event the Monitoring Committee considers that investigation with a view to discipline is necessary it should confine itself to dealing with issues affecting the audit registration, i.e. not impose a regulatory penalty before it refers for investigation. See also comments in respect of 1.3 and 2.2 of main paper.
Clause 8	See comments in respect of Clause 4.4 above.
Clause 11.3	In addition to specifying the date and venue, the time should also be specified.
Clause 12.7	The issuing of the report should be a matter for the IST, not the Monitoring Committee. An arrangement of the type proposed is inefficient and gives rise to a perception that the IST is in fact accountable to the MC.
Clause 14.1	It is not clear whether this is saying "at least one accountant" or "only one accountant". Generally this does not seem to fit well with the expressed desire that accountants should be in a minority.

Clause 14.2(c)	Again this gives rise to questions as to who would be a lay person. It might be simpler to refer to a "non-accountant". We would however want the accountant member of the IST to be a member of one of the major accountancy bodies which are RSBs.
Clause 14.2(e)	We propose that any professional accountancy body from amongst whose members tribunals are established should hold a Royal Charter.
Clause 14.2(f)	It clearly wouldn't be appropriate for a member of the ARC to sit on the IST and yet this clause would not preclude such an appointment. A member of the ARC is not a member of the governing body of ICAEW.
Clause 17.4	It would be better to require the appointment of a completely new tribunal. This would be consistent with our Disciplinary Bye-law 19(6). Particularly where a matter has, in effect, been part heard before it is abandoned it seems likely problems could arise if the new tribunal included any of the previous members.
Clause 18.2	See comment in respect of 2.4, paragraph 3. It is really unwise to include a provision which is simply unenforceable.
Clause 19	Deemed Service – The distinction between personal service and delivery by hand to premises is blurred. It may be that 19.1(a) can simply be amended to refer to delivery by hand to the latest address given by the addressee.
Clause 21.4	It is not clear why it is considered necessary to refer a breach of confidentiality to the Accountancy Scheme. In any event it is inappropriate to treat such a breach as evidence of non-co-operation with the Executive Counsel who will not have been involved.
Clause 22.1	A provision of this sort may have relevance in the context of disciplinary proceedings. Its only relevance in the context of audit regulation is in relation to fitness and propriety of individuals to act as Responsible Individuals which is not a matter included in this process. When deciding the amount of a regulatory penalty it would of course be relevant for the firm's "antecedents" to be taken into account. However the approach of treating previous disciplinary findings etc. as "conclusive evidence" gives rise to the question "Evidence of what?".

ICAS RESPONSE TO THE FRC CONSULTATION PAPER

Auditor Regulatory Sanctions Procedure

Background

The Institute of Chartered Accountants of Scotland (ICAS) received its Royal Charter in 1854 and is the oldest professional body of accountants in the world. We were the first body to adopt the designation "Chartered Accountant" and the designatory letters "CA" are the exclusive privilege of Members of ICAS.

ICAS is a professional body for 19,000 members who work in the UK and in more than 100 countries around the world. Our CA qualification is internationally recognised and respected. We are a Recognised Qualifying Body (RQB) for statutory audit. We are also a Recognised Supervisory Body (RSB). We have around 240 audit registered firms, of which five firms are involved in the audit of public interest entities and fall within the scope of the FRC's Audit Inspection Unit (AIU).

All 19,000 Members and our audit-registered firms presently fall within the scope of the FRC Disciplinary Scheme ("the Scheme").

Consultation

As a Participant Body, we welcome the opportunity to comment on the various proposals which affect the audit registered firms authorised by ICAS to conduct audit work in accordance with the Companies Act 2006. We recognise that the proposals simply seek to implement powers which were granted to the FRC by virtue of The Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2013 (SI 2012/1741). Our comments relate to the manner in which the FRC propose to implement the powers set out in the legislation and instead of addressing each of the consultation questions in turn, we would wish to offer the following observations.

1. In general, there is a lack of clarity in the consultation paper as to the position for delegated listed inspections and whether the relevant RSB or FRC would be responsible for the proposed sanctions.
2. More specifically, with reference to Paragraph 5.4 (and related provisions), there is a distinct departure from the terms of the provisions of the Audit Regulations of the RSB bodies, which are issued pursuant to the Companies Act 2006 ("the Audit Regulations"). Those Regulations do not provide for the "agreement" of the sanction set out a Paragraph 4.2. We understand that the FRC wish to expedite the regulatory process but the imposition of conditions or the suspension/withdrawal of an audit registration are <u>not</u> regulatory measures which ICAS would as a matter of course seek to "agree" in the first instance with any audit registered firm and the suggestion that the FRC would seek to do so with firms which are undertaking listed audit work will lead to inconsistency of approach.
3. With reference to the exercise of a more serious Sanction, such as suspension or withdrawal, it appears that a decision would be based solely on the limited monitoring undertaken by the FRC, that is only in relation to the major audits in the firm's client portfolio. The firm may well have a broad audit client portfolio which is not subject to the FRC monitoring arrangements. By contrast the relevant RSB body may not have any concerns over the relevant firm's ability to conduct audit work and there is no provision within the procedure for consultation with the relevant RSB over a firm's full firm procedures and non listed audit work.
4. The establishment of a regulatory and quasi-disciplinary arrangement is, again, inconsistent with the terms of the Audit Regulations. The Independent Sanctions

Tribunal described in the consultation paper appears to be quasi-judicial in nature. Whilst the potential inclusion of ICAS audit registered firms in this process may be limited compared with other RSB bodies, we feel bound to observe that many firms will undertake a variety of audit engagements, not all of which will fall within the FRC arrangements. For those firms, the FRC is seeking to create a two tier regulatory/disciplinary arrangement which we believe is undesirable.

5. With reference to Paragraph 12.9, we would observe that if decisions of the Independent Sanctions Tribunal are binding on the RSB bodies then any "direction" to the relevant RSB ought properly to be issued by the tribunal, and simply conveyed to the RSB body by the Monitoring Committee.

6. With reference to the composition of the Independent Sanctions Tribunal, the proposal that the three person tribunal should not include any practising auditors may satisfy the public interest but the Tribunal will require to understand the basis of the Firm's alleged failure to comply with the Regulatory Framework for Auditing before being able to determine the appropriateness of any Sanction. Without the ability to harness that expertise within the Tribunal panel, the presentation of the Monitoring Committee's case could be costly. No doubt the Nominations Committee and Panel will have regard to this requirement when selecting the Independent Sanctions Tribunal.

7. We remain concerned over the lack of clarity in relation to a firm's right of appeal. If the relevant RSB body is directed to impose a Sanction ordered by the Independent Sanctions Tribunal the current proposal could create a right of appeal to our Appeal Tribunal (being a decision of ICAS) or, possibly to the Courts by way of an application for Judicial Review. The relevant RSB will incur costs in such cases for a decision over which it had no involvement or control. We did highlight this issue during the initial consultation process and have not identified any safeguards within the current proposals.

We hope the above comments are of assistance to you.

We are grateful for the opportunity to comment on the procedure and look forward to receiving feedback in due course.

KPMG LLP
15 Canada Square
Canary Wharf
London E14 5GL
United Kingdom

Tel +44 (0) 20 7311 8630
Fax +44 (0) 20 7311 3311
DX 157460 Canary Wharf 5
mike.ashley@kpmg.co.uk

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

Our ref ma/ra

1 March 2013

Dear Sirs,

Auditor Regulatory Sanctions Procedure

We are pleased to respond to the invitation to comment on the proposed regulatory sanction procedure (the "Procedure"). We understand and fully support the need for the FRC to have its own appropriate regulatory sanctioning powers, although we note that in practice this has almost invariably been successfully achieved to date through the registration committees of the professional bodies.

It is important, however, that in applying these powers the FRC develops clear guidance on the application of the tests in section 4.1. In particular, for example, not every breach of an auditing standard (which might be viewed as a breach of the Regulatory Framework for Auditing) should in our view lead to a requirement to eliminate any possibility of it reoccurring – this would not be practical. In this context, we note that the consultation paper talks about "poor quality audit work" and "a material failure to comply with the Regulatory Framework for Auditing" neither of which appear explicitly in the proposed Procedure itself.

We also think that the use of these powers should not in any sense be confused with or used as a quick or expedient alternative to the disciplinary powers under The Accountancy Scheme of the FRC (the "Scheme"). In particular we believe that the Suspension or Withdrawal of Registration is such a serious sanction that it should only be contemplated in cases of misconduct. In the absence of the agreement of the Registered Auditor, the matter(s) giving rise to this proposed sanction should therefore be referred to the Scheme and dealt with in accordance with its provisions.

Also since, unlike in the disciplinary process, the Monitoring Committee effectively acts as the court of first instance, it is important that as far as possible this committee acts and is seen to act impartially and not just as an arm of the AQR. In this regard we believe that it would be helpful if the AQR, in making any recommendation on sanctions to the Monitoring Committee, provided an "impact" analysis clearly articulating not just the anticipated benefits, but also the costs and potential unintended consequences of any measures proposed. This we believe will

greatly assist the Monitoring Committee in considering if a case has been made that any proposed sanctions are indeed appropriate.

We also understand that the Monitoring Committee contains no practising accountants as members, although this is unclear as the membership is not published – a matter which incidentally we believe should be rectified. If this is the case we believe that the Monitoring Committee should consider taking views regarding any proposed restrictions or conditions from a practising accountant with experience of managing a firm of the relevant size to assist their assessment of the practical implications of the proposals and/or alternatives.

Finally there does not appear to be any provision for an appeal to the decision of an Independent Sanctions Tribunal even on the narrow grounds permitted by both the FRC in relation to Disciplinary Tribunals and the ICAEW in relation to the Review Committee which hears appeals from decisions on regulatory sanctions made by the Registration Committee.

On more detailed matters, we have provided responses in the Appendix to the specific questions in the consultation document.

We hope that you find these comments helpful in taking forward the proposals and would be happy to discuss them if you wish.

Yours faithfully

KPMG LLP

KPMG LLP

Appendix

Question 1: Do you consider the proposed Procedure to be understandable?

We consider the proposed Procedure generally to be understandable insofar as it goes. In this respect we note that under section 3.1(i) the Conduct Committee has the power to provide, *inter alia*, the Monitoring Committee with guidance on the exercise of their duties under the Procedure. We believe that it is important that such guidance should contain the suggestions made in our covering letter as well as guidance on the types of sanctions which should be considered and in what circumstances; such guidance should be published and comments sought thereon.

We do note that in a number of places the proposed Procedure refers separately to the failure to comply with the Regulatory Framework for Auditing and the criteria in section 4.1. As expressed in section 4.1, however, the failure to comply is itself one of the criteria and that is how we have addressed it in our further comments below.

Question 2: Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to the Procedure?

As well as the matters raised in our covering letter we have the following observations in this regard.

We welcome the restriction in section 4.1(a) to "Major Audit" clients, although given the inclusion of "or any other person" this does not seem very effective. We believe it would be appropriate to give further consideration to this in view of the FRC's remit and focus.

We referred in the covering letter to the composition of the Monitoring Committee. On the assumption it contains no practising accountants we also suggest that consideration is given to the expertise that the Monitoring Committee will have recourse to in exercising its powers under section 4.2(d).

The alternative presented by "or" in section 5.1(a) would seem to have the following effects:

- Require the AQR to write to the Registered Auditor in the event that the proposed report to the Monitoring Committee indicates a failure to comply with the Regulatory Framework for Auditing even where there is no recommendation for sanction. This occurs today as a matter of course in that drafts of the private report are discussed between the firm and the AQR and whilst we fully expect that to continue, it would not seem necessary to provide for it formally in a document concerned with regulatory sanctions.
- Allow the AQR to propose recommending a sanction to the Monitoring Committee before formally concluding even whether there has been a failure to comply with the Regulatory Framework for Auditing.

We therefore suggest the "or" is deleted and section 5.1(a) should only be triggered when there has been both a failure to comply with the Regulatory Framework for Auditing and the AQR are recommending a sanction. Furthermore we do not believe it is appropriate for the AQR to recommend a sanction unless they have also formed the view that the other criteria in section 4.1 have been met. It should not be left just to the Monitoring Committee to form this view (as required in section 5.2) without any opinion being expressed by the AQR who are the ones who have had full access to the Registered Auditor and conducted the detailed work.

Section 5.1 allows only 14 days for the Registered Auditor to respond. We would hope that in most cases there will have been an ongoing dialogue with the AQR such that 14 days might be achievable. However in some cases this deadline will in our view be far too short and there is no allowance for it to be extended (in contrast to section 6.3 with regard to notice of proposed sanction).

Section 5.1 also contains no guidance as to what the AQR should include in the request to the Registered Auditor for comments. At a minimum we believe that the AQR should be required to state why it considers that the criteria in section 4.1 have been met (see above). If the AQR has recommended a sanction to the Monitoring Committee it should also be required to state what that sanction is and why the AQR believes it is appropriate in relation to the issues identified.

In providing the written notice to the Registered Auditor in accordance with section 6.2 we note that the Monitoring Committee is required to state why it considers the Registered Auditor has failed to comply with the Regulatory Framework for Auditing (6.2(a)). In addition we believe the Monitoring Committee should also be required to state explicitly why it believes the criteria in 4.1(a) and/or (b) are met. In providing the information under 6.2(b) on why the proposed sanction is appropriate the Monitoring Committee can then link it specifically both to the failure, and also how it will mitigate the concerns under the criteria. A similar consideration applies to the notice provided under section 11.2.

We do not agree that the public interest test in section 7.4 strikes the right balance in that we are of the view that such details should be published only when it is in the public interest to do so. It is also unclear whether it is proposed to publish details of any written Undertakings and if so we consider they should be subject to the same test. Similar considerations also apply to any decisions of the Independent Sanctions Tribunal (section 12.9) and in addition we do not believe that in these cases it is appropriate for the Monitoring Committee to apply the test rather than the Tribunal itself.

Section 11.3 provides for only 21 days notice of a hearing before the Independent Appeals Tribunal and this is in our view inadequate to prepare for a hearing. Although a further 21 days are allowed for the written response to the findings of the Monitoring Committee, 6 weeks should not necessarily be regarded as the overall time allowed to prepare, as it may not be apparent at that stage that, for example, the Monitoring Committee will not accept written Undertakings. In our opinion therefore there should be a minimum period of 6 weeks between the date the Monitoring Committee sends a notice of referral to the Registered Auditor and the date of a hearing. This is less than the 8 weeks specified in the Scheme for notice of a hearing before a Disciplinary Tribunal which reflects the different nature of the cases they are hearing, but still allows sufficient time for preparation.

Under section 12.5 the Independent Sanctions Tribunal makes a finding only as to whether there has been a failure to comply with the Regulatory Framework for Auditing without reference to the criteria in section 4.1(a) and (b). Whilst under section 12.5(a) the Independent Sanctions Tribunal should apply a sanction which it considers appropriate it is not clear whether in determining what is "appropriate" it has regard to these criteria and we believe this should be made explicit.

Finally in order to assist in distinguishing the proposed Procedure from the Scheme we believe it would be appropriate to ensure that the panel of potential Independent Sanctions Tribunal members should be entirely separate from the panel of potential Disciplinary Tribunal members.

Question 3: Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

We note that the Procedure does not appear to provide explicitly for the process to be followed if the Monitoring Committee determines in accordance with section 7.1(b) that an amended or lesser Sanction is appropriate. We presume that in this event the Monitoring Committee will repeat the steps in section 6, but it would be helpful if this could be clarified.

It is also unclear whether the Independent Sanctions Tribunal can hear evidence relating to written Undertakings that have been offered and rejected by the Monitoring Committee. We presume they can, but it may be better to make this clear.

The provisions under section 17.1 permitting a hearing before the Independent Sanctions Tribunal to be postponed do not seem to allow for the potential incapacity (or other good reason) preventing the Registered Auditor from attending.

Question 4: Do you have any other comments about the proposed Procedure?

We have no other comments about the proposed Procedure.

MAZARS

Sophie Broom, Communications Executive
The Financial Reporting Council
5th Floor Aldwych House
71-91 Aldwych
London
WC2B 4HN

Direct line +44 (0) 207 063 4369
Email Kim.hurst@mazars.co.uk

28 February 2013

Dear Ms Broom,

Auditor Regulatory Sanctions Procedure

Introduction

Mazars, the integrated international accountancy, auditing and advisory organisation with more than 13,500 professionals in 71 countries, welcomes the opportunity to provide our comments on the FRC's consultation on the proposed auditor regulatory sanctions procedure.

Consultation questions

Question 1: Do you consider the proposed Procedure to be understandable?

Audit firms should not be subject to the Procedure very frequently and as being the subject of regulatory action is distressing, it is vital that the Procedure is clear. We set out here some areas where the Procedure's clarity could be improved:

Paragraph 1.3 states that the Procedure relates only to poor quality of audit work. This implies that there are a number of matters covered by Audit Regulations which will not be subject to this procedure for example, the signing of an auditor's report by someone who is not a Responsible Individual.

Paragraph 1.4 deals with consistency with RSB procedures. Presumably the recommended level of penalty imposed and the various matters which aggravate or mitigate the penalty will remain the same as those recommended by the RSBs.

We would welcome clarification of the plans for publicity of any penalties including how "public interest" would be determined. We presume that publication will be the responsibility of the RSB i.e. there will be no publicity prior to determination of the matter by the RSB.

12.3 of Annex B. It is not clear to a non lawyer what is meant by the following: 'the IST may take in to account any evidence it considers relevant, whether or not such evidence would be admissible in a court.'

14 of Annex B. It is not clear why a 'lay person' is not simply described as a non accountant. Is this not what is meant by 'lay person' in this context?

21.4 of Annex B. The Executive Counsel's involvement in this Procedure is not spelled out therefore it is unclear why a breach would be deemed to be evidence of failure to cooperate with him.

22.1 of Annex B. We would hope that in the interests of fairness prior disciplinary records would only be taken in to account in the setting of any penalty once a matter had been decided.

Question 2: Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to the Procedure?

The IST process will involve the Registered Auditor in significant time and (legal) expense which may not be fully covered by insurance. Thus we envisage that all but the largest firms may feel pressurised in to accepting the MC's sanction. However, we accept that the proposal is similar to regimes currently in place in the RSBs.

12.6 of Annex B. It is not clear why the IST communicates its findings via the MC. If it does not report directly to the firm which has effectively 'appealed' to it then it is unlikely to be viewed as being 'independent'.

Question 3: Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

No, other than matters highlighted in response to other questions.

Question 4: Do you have any other comments about the proposed Procedure?

We remain concerned that the proposals may lead to delays and difficulties in the finalisation of AQR reports on firms. It is in the public interest that these reports are not unduly delayed. It seems that the Procedure may lead to protracted legal argument before points raised in reports are accepted by firms. FRC disciplinary processes have been bedevilled by protracted delays in the past and the profession needs reassurance that competent resourcing will be in place to deal with matters efficiently without being unfair to firms and to the individuals concerned.

The AQR process and the publication of full reports on the largest of firms provide a strong motivation to such firms to seek continually to improve audit quality and to be seen to act on recommendations. The FRC should have confidence in its own processes and not lose sight of this. It would be a shame if these changes moved to more of a 'big stick' regime with the consequent risk of less transparency between those involved in the AQR process and the diversion of resource in audit firms from the promotion of audit quality to defence of the firm.

If you would like to discuss our response with us please do not hesitate to contact Kim Hurst on 0207 063 4369.

Yours faithfully

Mazars LLP

Mazars LLP

FRC 5th floor,
Aldwych House
71-91 Aldwych London WC2B 4HN
Telephone: +44 (0)20 7492 2300
Fax: +44 (0)20 7492 2301

consultations@frc.org.uk
Submission Deadline Friday, 1 March 2013.

Dear Sir

Response to the Auditor Regulatory Sanctions Procedure – consultation paper

This proposal needs to be more realistic and practical by the simple addition of **20% or more** of the fine going back to the FRC Unit in addition to the costs of bringing the proceedings.

Why? In a practical world of judges and opinions there will be some cases that for whatever reason or pressures loses. There are also many cases that are investigated but that do not proceed costing money.

For this investigation Sanctions procedure by the FRC to be self supporting financially an allowance must be made for these written off costs of investigation otherwise the unit will be a continual gradual drain on the FRCs financial resources and other parties until nothing happens (as the professional institutes may wish)

Based on past case histories and judgments' please amend the likely fee percentage needed. Based on payouts probability multiplied by the probable range of Net financial outcomes. The surplus if there is any can then be returned after 3 years.

Also the unit should have a budget for 3 years of negative cash flow to allow for the typical cashflow drain in starting a new business and the likely years of delay and foot dragging through the legal process until income exceeds costs.
Thank you

Yours faithfully

G Palmer
Private Investor
Member of ShareSoc Member of UKSA
c/o 27 Mapledale Avenue East Croydon CR05TG

Financial Reporting Council
5th Floor, Aldwych House
77-91 Aldwych
LONDON
WC2b 4HN

For the attention of Sophie Brown, Communications Executive
By E-mail: consultations@frc.org.uk

28 February 2013

Dear Sirs

Consultation Paper – Auditor Regulatory Sanctions Procedure

We appreciate the opportunity to comment on this consultation paper from the Financial Reporting Council (FRC) on the proposed Auditor Regulatory Sanctions Procedure (the Procedure).

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

We fully support the FRC's aim of enhancing the perception of the independence of the regulatory sanctions process and believe that the Procedure as set out in the consultation paper will go some way to achieve that aim. In our detailed responses to the questions in the attached Appendix we suggest some clarifications that we believe would further enhance the transparency and aid understanding of the process which will help to ensure that it is fair to those subject to the Procedure.

Interaction with other disciplinary processes and the risk of "double jeopardy"

We agree with the FRC's intention that where the Audit Quality Review identifies potential instances of Misconduct, those matters should fall outside the scope of the Procedure and instead an appropriate referral should be made to the relevant disciplinary scheme. However, it is unclear from the Procedure as currently drafted as to how the Procedure is intended to interact with other disciplinary schemes (whether of the FRC or the relevant RSB). It would appear possible for those subject to the Procedure to have sanctions imposed upon them by the Monitoring Committee/Independent Sanctions Tribunal as well as being subject to the Accountancy Scheme of the FRC (the Scheme) or a disciplinary scheme of the RSB. This would create a situation of "double jeopardy" for the Registered Auditor with the risk of being punished twice for the same matter by different bodies. We do not believe that this is the FRC's intention.

We suggest in our response to Question 2 some amendments that we consider would help clarify the Procedure and avoid this risk.

pwc

Distinction between regulatory and disciplinary responsibilities

In our recent responses to both the FRC's Reform proposals and the Disciplinary Schemes Proposed Changes consultation paper we raised concerns about the risk of blurring the distinction between the supervisory and disciplinary functions of the Conduct Committee (CC) and ensuring that appropriate governance safeguards and clear roles and responsibilities exist for the CC. We further noted that following implementation of the FRC's Reform proposals, the CC will set strategic goals for the FRC's supervisory, monitoring and disciplinary work. There is therefore a risk that it could be perceived to have overlapping and potentially conflicting responsibilities and objectives.

The differing activities require the FRC to maintain relationships with, and to treat fairly and be accountable to, a range of stakeholders – and to manage potentially conflicting roles. We would be concerned if supervisory inquiries initiated in pursuit of the FRC's various regulatory objectives were to trigger automatically a series of associated disciplinary processes.

We continue to believe that, as a body acting in the public interest, the FRC should be seen to be setting an example of good governance in its own arrangements. This would include ensuring appropriate safeguards to manage differing and overlapping public interest objectives, and reviewing periodically the effectiveness of its operations. We suggest an evaluation of the governance arrangements of the CC as part of that review, to assess how the CC is managing its different activities and responsibilities to stakeholders.

We would be pleased to discuss our views further with you. If you have any further queries in the meantime regarding this letter, please contact Chris Taylor (020 780 42677) or Margaret Cole (020 721 22016).

Yours faithfully

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

pwc

Appendix

PwC detailed responses to the questions in the Consultation Paper

1. Do you consider the proposed Procedure to be understandable?

Whilst we support the overall aims of what we believe the Procedure is seeking to achieve, and understand much of the Procedure as it is currently drafted, there are a number of aspects of the Procedure which require clarification to facilitate a full understanding and ensure that the Procedure meets its aims.

Section 3.1 states that the Conduct Committee (CC) can provide the Monitoring Committee (MC), Convener and the Independent Sanctions Tribunal (IST) with guidance concerning the exercise of their duties. The Procedure should be clear as to what the guidance will cover such as determination of fines, sanctions, tariffs and factors to be considered in making any determination. This would be consistent with other existing processes. The guidance (upon which we believe it would be appropriate to consult) should also be published at the same time as the Procedure.

Section 4.2 sets out the sanctions to which a Registered Auditor shall be liable, including restrictions and/or conditions, suspension or withdrawal of registration and a regulatory penalty. The regulatory penalty is defined as "a fine of an amount determined by the Monitoring Committee or the Independent Sanctions Tribunal". There is no reference to a tariff nor a mechanism for determining the regulatory penalty for the MC and IST to refer to and apply, as is the case for fines imposed by RSBs. There is also no reference to any limit on the fines which could be imposed and hence, as currently drafted, the fines imposed on the Registered Auditor could be unlimited. Published guidance is needed to prevent inconsistencies arising between cases and to maintain the integrity and transparency of the Procedure. Further, whilst we agree that it may be appropriate to sanction poor quality audit work; any regulatory penalty should be proportionate and be seen as fair in the circumstances. We also assume that one or more of the sanctions set out in section 4.2 could be imposed in any situation although it is unclear from the current drafting.

We consider that the definition of the "Regulatory Framework for Auditing" as currently drafted is too broad such that any law or regulation (including guidance) relevant to the audit would fall within the definition. The wording in the definition "or other documents from time to time in force" is particularly unhelpful and vague. We would suggest that the definition be amended to add "which are significant to the performance [and quality] of the audit work" at the end of the definition after points (a) to (e).

Sections 5.1 and 5.2 of the Procedure set out when the MC could determine that a sanction is required. However, the interaction of the definition of the "Regulatory Framework for Auditing" as noted above and section 4.1, and in particular section 4.1(b), could result in a Registered Auditor being subject to the Procedure for simple errors or mistakes. The Procedure should apply in situations where there is more than just mere non-compliance but, as noted below, it also must not apply in situations where there is "Misconduct" as defined in

either the Scheme or the relevant disciplinary scheme of the RSB. Given the judgemental nature of many aspects of the audit, much greater clarity is needed as to what situations would result in sanctions being made against the Registered Auditor.

Section 6.2(c) allows the Registered Auditor to make representations in writing in the 21 days following the sanctions notice being issued. The Procedure should clarify that these representations can be made partly or wholly on a "without prejudice" basis and should consider allowing oral representations and discussions to take place.

Sections 7.4 and 12.9(c) state that the MC will publish details of the Sanction "in such a manner as it thinks fit unless this would not, in the opinion of the MC, be in the public interest". If the aim of the Procedure is to improve the perception of independence and an overall desire for transparency, guidance should be provided as to when publishing details of a Sanction would not be in the public interest. Further, where under section 8.1 a Sanction is varied or revoked, we would also assume that the FRC intended that details of such a variation or revocation would also be published. We suggest that the Procedure be revised to deal with these apparent inconsistencies or drafting omissions.

Paragraph 1.3 in the "Background" section of the Consultation paper states that "such action may only be taken against the Registered Auditors (being member firms including sole practitioners registered as auditors by the relevant RBS)". However, the Procedure as drafted does not make this point clear and that the Procedure does not apply to individuals nor does it seek to impose sanctions on individuals.

2. Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to the Procedure?

We do not agree that the Procedure achieves this aim because of the lack of clarity, as noted above, which together with the concerns noted below could prejudice those subject to the Procedure.

Section 5.5 of the Procedure allows the MC to refer matters to the Conduct Committee where they indicate that the conduct of the Registered Auditor needs to be considered in accordance with the provisions of the Accountancy Scheme of the FRC (the "Scheme") or the disciplinary procedures of the relevant RSB. However,

- Section 5.5 does not make it clear that this should only arise in respect of "Misconduct" as defined in either the Scheme or the relevant disciplinary scheme of the RSB which seems to be the intention from statements made in the consultation paper; and

- Section 5.5 should also state that where the matter is referred to the Conduct Committee, or indeed the RSB, the MC shall take no further action until the Conduct Committee or RSB decides whether to bring disciplinary actions against the Registered Auditor. In the circumstances where the Conduct Committee or RSB decide to bring disciplinary action against the Registered Auditor, the MC should take no further action. At present, the interaction between the proposed Procedure and the other disciplinary schemes of the FRC or RSB is unclear and could lead to sanctions being levied on the Registered Auditor for the same

offence by two different bodies (i.e. "double jeopardy"). We do not believe that this was the FRC's intention.

Section 5.1 should be clarified to require the AQR's notification to the Registered Auditor to clearly state the areas of the AQR's concerns so that the Registered Auditor is able to understand, at this stage of the process, the specific criticisms which are being raised. Further, the AQR's report to the MC should be disclosed to the Registered Auditor together with the "further information" referred to in section 5.5. In addition, the Procedure does not set-out how the FRC's case will be documented or presented and at which stage of the process this will be provided to the Registered Auditor. The Procedure also does not state what documentation is to be provided to the IST by the FRC or require that material to be provided to the Registered Auditor. Without such disclosures and clarity, the Procedure could be seen to be unfair to the Registered Auditor especially if the MS or IST are considering criticisms or information of which the Registered Auditor is unaware.

The Procedure does not include the provision for the Registered Auditor to make written representations to either the MC or the IST. Whilst the Registered Auditor is able to attend the IST and be represented, and the Registered Auditor can make written representations to the AQR in advance of their report to the MC (section 5.1), there is no such provision for the MC which meets in private and proposes a sanction without any representation, written or otherwise, from the Registered Auditor. This would be unfair to the Registered Auditor.

The Procedure does not include any provision for an appeal against sanctions agreed by the IST. There should be a right of appeal where sanctions are determined by the IST otherwise this would be unfair on those subject to the Procedure and inconsistent with the Disciplinary Scheme where an appeals process does exist.

3. Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

The Procedure does not permit the Registered Auditor, or a representative, to attend and/or participate in the MC meeting at which a sanction is determined. Although the Registered Auditor has 21 days to respond to the notice, it may speed up the process and reduce the number of referrals to the IST if the Registered Auditor were permitted to attend and/or make representations at the meeting.

4. Do you have any other comments about the proposed Procedure?

Section 4.5 permits the MC or IST to accept "written Undertakings" from the Registered Auditor yet "Undertakings" is defined in section 2.1 as meaning the "written undertakings as referred to in paragraph 4.5...." which appears to be circular.

Section 5.1 states that the Registered Auditor is invited "to make any representations in writing within 14 days" but 6.3 allows the Monitoring Committee "in its absolute discretion [to] extend the period in the Registered Auditor can respond to the notice". It would be beneficial to all parties for the Monitoring Committee to be able to exercise the same discretion in section 5.1 to extend the period beyond 14 days should the need arise.

Section 5.3 states that where the MC decides to take no further action against the Registered Auditor that it will notify the Registered Auditor (5.3(a)) and then notify the relevant RSB (5.3(b)). As

currently drafted, there is no provision under the Procedure for the relevant RSB to have been notified that the MC is considering a matter referred to it by the AQR such that the first the relevant RSB becomes aware of a matter having been considered by the MC is that no action is being taken by the MC against the Registered Auditor. If the FRC is seeking to improve transparency, we would suggest that any matter which the MC is required to consider is communicated to the relevant RSB at that point rather than at the end of the process. We would however question what the FRC would expect the relevant RSB to do upon receipt of a notice stating that no action is to be taken against a Registered Auditor.

The Procedure does not deal with the issue of costs in the circumstances where the MC decides that no further action is to be taken (section 7.1/7.2) or the IST decides to dismiss the case (section 12.4) as the Registered Auditor will have incurred costs. Unlike some such processes where there is little or no knowledge at the start of the process as to what issues may or may not exist with regards to the work, under the Procedure, the MC and IST has a high degree of knowledge from the report it receives from the AQR as to what the issues are (i.e. there is no investigation phase performed by the MC or IST). If the MC and IST having initiated the process based on this level of knowledge decide to dismiss at a later stage, costs will have been incurred by the Registered Auditor which the Procedure does not explain who is responsible for them or why.

The impact of sections 7.4 & 12.9 on publication of sanction decisions may be that the FRC will issue a greater number of press releases about auditors being disciplined or sanctioned than is currently the case. Clearly it is important that the FRC, as an independent and credible audit regulator, is seen to be taking action where there are failings that warrant such action, and we recognise there is an *"unless publication would not be in the public interest"* provision included in 7.4. However, we suggest the FRC consider the wider effects of striking an appropriate balance between transparency of regulatory sanction decisions and ensuring that more frequent publicity about sanctions does not inadvertently undermine confidence in auditing and in regulation of the profession.

Section 9.1(b) provides that when the Registered Auditor does not agree a Sanction, the MC sends a notice that the matter is being referred to the IST. However, the Procedure, which details the formalities for various aspects of the process, does not actually specify how the Registered Auditor is required to inform the MC that they do not agree the Sanction.

Section 12.7 requires the MC to send a copy of the IST's report to the Registered Auditor and the relevant RSB and section 4.4 states that a sanction can be effected by "way of direction from the MC or IST to the relevant RSB". If the aim of the Procedure is to improve the perception of independence then the IST should send a copy of its report direct to the Registered Auditor, the relevant RSB and the MC rather than the MC being an intermediary. In addition, because of the wording of section 4.4, as the IST can direct the relevant RSB to effect a sanction, this would also be more efficient.

Section 14.2(c) requires the IST to include an "accountant" and a "lay person (who is not an accountant" and section 14.2(e) states that an accountant is "a Member of a professional accountancy body whether or not that body is an RSB". As we note below, it would be beneficial that one member of the IST be a member of one of the accountancy bodies who are RSBs. In addition, it may be also beneficial to clarify further the definition of who it is envisaged could act as the "lay" person – for example someone who is not an accountant, lawyer or regulator and who is independent of all parties involved in the Procedure.

Section 14.2(f) implies that a member of the Audit Registration Committee (ARC) could be a member of the IST because the ARC is not a governing body of the ICAEW. This would not be appropriate because the individual would determine the sanction as a member of the IST and then be required to implement it as a member of the ARC which would reduce the independence of the process.

Section 17.4 states that where a new IST is convened, members of the original IST can be appointed to the new IST. This would be inconsistent with other similar processes and to maintain independence in such scenarios, the new IST should consist entirely of new members.

Section 18.2 states that no member of the IST can abstain from voting and we are puzzled as to why this is included in the Procedure and question whether this can be enforced or how it is planned to force an individual to vote or not to vote, as is their right, especially when section 18.1 provides for a majority decision.

Section 21.1 seems to empower the FRC to disclose to any other regulatory body anywhere in the world all information and evidence obtained under the Procedure by the Monitoring Committee and the IST. This seems a very broad-ranging power and we question whether all such information and evidence should be made available where, for example, a case is dismissed and no sanctions are applied. It is important to remember that restrictions already exist with regards to working papers and to whom they may be sent as protocols do not exist for doing so in most situations.

It is unclear why section 21.4 refers to a breach of confidentiality being regarded as evidence of failure to cooperate with the Executive Counsel when the Executive Counsel does not appear to be involved in any aspect of the Procedure as currently drafted.

Section 22.1 states that the MC and IST will accept any previous disciplinary findings, convictions etc as conclusive evidence of that prior matter but it does not state whether prior matters are to be considered by the MC or IST in determining a sanction, although this could be prejudicial to those subject to the Procedure in some instances. It is also unclear as to what it is "conclusive evidence" of and whether, due to different facts and circumstances which may exist, prior matters are relevant. Whilst we agree that where a prior matter is relevant to the current case before the MC or IST it may be appropriate to take it into consideration when determining a sanction, the Procedure should be amended to make this clear and how prior matters are to be used.

Involvement of the Professional Bodies

The proposed Procedure does not involve the relevant professional bodies in the process itself. While we understand the FRC's desire to increase the perceived independence of the Procedure, as noted in our response to the Disciplinary Schemes Proposed Changes consultation paper, we believe that there should continue to be sufficient consultation with those bodies as we believe this is important to the quality of the decision-making. Given the significant consequences of the Conduct Committee's decisions, especially in relation to disciplinary matters, it is important that the decisions made are fair and robust. The considerable experience which the professional bodies have, including with regard to what may be expected of Members and Member Firms in relation to the audit process, is not something that should be lost. Furthermore, those who conduct the investigative function within the ICAEW are separate from other parts of that body. This helps to underpin the objectivity of those at the ICAEW looking into matters of conduct.

Ernst & Young Global Limited
Becket House
1 Lambeth Palace Road
London SE1 7EU
Tel: +44 (0)20 7980 0000
Fax: +44 (0)20 7980 0275
www.ey.com

Ms Sophie Broom
FRC
5th Floor Aldwych House
71-91 Aldwych
London
WC2B 4HN

28 February 2013

Ref:

Direct line: 020 7951 3050

Email: roverendx@uk.ey.com

By post and email to: s.broom@frc.org.uk

Dear Ms Broom

FRC Consultation Paper - Auditor Regulatory Sanctions Procedure

Ernst & Young LLP welcomes the opportunity to respond to the above consultation paper. We have no fundamental concerns about the process proposed, and we recognise that the FRC has sought to include balance and safeguards in the process. We would however observe that ultimately the success of this scheme will depend critically on the way it is applied in practice – all stakeholders will have to be comfortable that a proportionate approach is being followed. We would therefore suggest that the FRC should undertake a formal review of the procedure post implementation.

Detailed Comments

Section 5.1 of the Procedure refers to the AQRs "reports" to the Monitoring Committee. We are unclear whether this refers to existing reports currently prepared by AQR (i.e., letter style reports and supporting underlying tracker documents, and the public report on the firm) or whether it is anticipated that a further report will be prepared specifically for the purposes of the Regulatory Sanctions Regime. We believe it would be helpful if this is clarified. We are also unclear as to what criteria will be applied by the Monitoring Committee in assessing whether the conditions described in section 4.1a) and 4.1b) exist. We believe that it is important that these criteria are fully understood by all parties.

We believe that current section 5.1(a) would cause the AQR to write to substantially all Registered Auditors. We say this because, as drafted, any breach of the Regulatory Framework for Auditing, which as defined would include even minor failures to comply with auditing standards (which we anticipate substantially all AQR reports will identify) would require the AQR to write to the Registered Auditor. We do not believe that this is the FRC's intention, and we assume that this process will only be initiated if it is believed that the criteria of 4.1 are satisfied. We would therefore recommend deleting 5.1(a) and amending current 5.1 (b) to state "Where the Monitoring Committee receives a report from the AQR which includes any recommendation for sanction or which, in the opinion of the Monitoring indicates...may be satisfied".

Finally, we note that the Procedure has been drafted on the basis it should be consistent with the RSB's procedures, in particular those set out in the Audit Regulations. In relation to sanctions, we believe that it would help improve certainty and clarity for the Procedure to confirm that the Independent Sanctions Tribunal (IST) will adopt the guidance of the relevant RSB to which the matter would otherwise have been referred, and that the IST will be bound by any relevant precedents of such RSB.

If you would like to discuss our response further please do not hesitate to contact me

Yours sincerely

Robert Overend
Ernst & Young LLP

BAKER TILLY

First Floor, Quay 2
139 Fountainbridge
Edinburgh
EH3 9QG
United Kingdom

T: +44 (0)131 659 8300
F: +44 (0)131 659 8301

www.bakertilly.co.uk

Our ref: TM/AT
Your ref:

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

4 March 2013

Dear Ms Broom

the Auditor Regulatory Sanctions Procedure ('ARSP')

I am writing to you on behalf of the senior partners of the 'Group A' firms (the 'mid-tier', nine next-largest firms, beyond the 'Big 4', Grant Thornton, and BDO)[1]. It is written in answer to the Financial Reporting Council's consultation the new *Auditor Regulatory Sanctions Procedure*, in relation to new powers given to the FRC by amendments to the Companies Act 2006.

Broadly speaking, the consultation is asking whether the ARSP is comprehensible and fair in its terms, and we have therefore focused our response on those two points, seeking assurance on *fair application* of the Procedure, as opposed to its terms.

The first is in relation to para 1.3 ('Scope of the Procedure') which says that, "*The power to determine sanctions as set out in the Procedure relates only to poor quality audit work identified by AQR... which is considered to warrant regulatory action.*". It is important that the operational working context the AQR will use is construed not merely within the confines of that statement but within the defined terms of the Procedure: as we understand it, the Procedure may only be invoked where the dual test referred to at para 2.2 ('Scope and Application') is satisfied –

In other words, the Procedure cannot be applied unless there has been both (i) a failure on the part of a Registered Auditor to comply with Regulatory Framework for Auditing, and (ii) it is believed that the Registered Auditor's "*continued registration or continued registration without restrictions or conditions could adversely affect a Major Audit Client or any other person; and/or it is necessary to impose a sanction to ensure that their Statutory Audit Functions are undertaken, supervised and managed effectively.*"

[1] Baker Tilly, Crowe Clark Whitehill, Haines Watts, Kingston Smith, Mazars, Moore Stephens, RSMTenon, Saffery Champness, and Smith & Williamson.

This is a cumulative test and we assume that it cannot be satisfied unless both of these conditions are demonstrably satisfied. The intent seems clear: that it is not *any* infraction, however slight, of a provision under the Regulatory Framework for Auditing[2] found during AQR visits that would lead to the imposition of a regulatory sanction.

The other point we would stress relates to a topic that is important to our firms and that was expressed to Paul George at a recent ICAEW/FRC/Group A breakfast: that our firms are under-represented in the FRC's infrastructure in the round. That inevitably leads to concerns that the FRC's enforcement powers (however unconsciously) might be disproportionately deployed against us and that AQR inspections bear disproportionately against us, in comparison with the largest firms[3], and that the uniformity of the inspection process across larger and smaller firms is an issue.

These are real, not fanciful, concerns, though we have two suggestions that would help address them.

The first is that the results of AQR ought to be *moderated* not merely within the confines of the AQR itself but subject to qualitative, external, appraisal in which representatives of our firms play a part.

The second is to reconsider the complement of the Monitoring Committee. Whereas we would understand an imperative to ensure that there is significant lay representation on that Committee (that, after all, is stated at para 1.2 as the rationale for change, removing the Recognised Professional Bodies' role), it is clear from para 2.3 that the Monitoring Committee's "*...meetings, which will be held in private, may also be attended by other persons in advisory roles which in practice will be AQR staff. Registered Auditors do not attend these meetings.*".

The FRC is subject to the Hampton Principles of fairness, the predominantly important one of which is Proportionality: we have made suggestions that would go some way to restoring balance in the equation between public and private interests, a balance which we think is unfairly imperilled by the process you have in mind.

We observe too that, if, as the consultation paper says at para 1.4, "*[the Procedure] should be compliant with Article 6 (right to fair trial) of the European Convention on Human Rights*", the omission of the additional checks and balances of the kinds we mentioned above causes that end not to be achieved.

These preliminary points made, we offer specific responses to the consultation questions, as follows:

[2] The ISAs, Ethical Standards for Auditors, QC Standards for Auditors, and the Audit Regulations.
[3] For example, the ratio of AQR inspections to numbers of major audits we actually have is far higher than for the largest firms.

Q1 Do you consider the proposed Procedure to be understandable?

Yes.

Q2 Do you agree that the Procedure achieves a balance between protecting the public and fairness to those subject to the Procedure?

We emphasise the points we made at the start of this letter – issues of fairness are about proportionality. Whereas written procedures may be fair in the abstract, *real* fairness is about making sure the practice of applying them - the process of applying the Procedure - is proportionate and we have real concerns in this respect. Regulation is primarily about the sharing of best practice with a view to achieving quality of professional opinion; it is not about frequent and unthinking recourse to punitive measures, the sheer scale of which may penalise our firms proportionally much more severely than the largest ones.

Q3 Do you consider there is anything missing from the proposed Procedure that would improve its effectiveness?

Effectiveness is a function of the perspective one views it from: the Procedure is intelligible and workable but in its present terms represents neither a fair balancing of interests nor is likely to achieve the optimal result from the point of view of the public interest. It *appears* predisposed to the imposition of regulatory sanctions as there is no discussion of the educative value of regulation or achieving total audit quality through the collaboration of profession and oversight. If, as we apprehend, the intention is to secure additional punitive powers as an end in itself, then we do not think the public interest is best served in that way. That may not be the intention but it appears to us to be the result. Greater attention to intellectual coherence of the regulation piece in the round should have been paid in the consultation paper, and we hope that the suggestions we have made are helpful in that regard.

Q4 Do you have any other comments about the proposed Procedure?

No.

As always, we stand ready to meet and discuss any of the matters we raise above and seek that opportunity.

Yours sincerely

T M McMorrow

T McMorrow
Secretary to the Group A Firms