Think Ahead ACCA

Independent review of the Financial Reporting Council's enforcement procedures sanctions

Review Panel's call for submissions

Comments from ACCA
June 2017

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Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 188,000 members and 480,000 students in 178 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 100 offices and centres and more than 7,400 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting, and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

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GENERAL COMMENTS

ACCA welcomes the opportunity to make submissions to the Review Panel as part of its independent review of the FRC's enforcement procedures sanctions. The key principles that we set out in this submission, and which guide our responses to specific questions, are underpinned by case law as follows:

- It is settled law that the purpose of sanctions issued by a regulatory body is not to be punitive but to protect the public interest - *R (on the application of Abrahaem) v General Medical Council* [2004] EWCH 279 (Admin).

- The Court of Appeal in *Raschid and Fatnani v The General Medical Council* [2007] EWCA Civ 46 made it clear that the functions of a disciplinary tribunal are quite different from those of 'a court imposing retributive punishment'. The Court of Appeal went on to confirm, 'the panel is then concerned with the reputation and standing of a profession rather than the punishment of a doctor'. The public interest must be at the forefront of any decision on sanction, and this includes the collective need to maintain confidence in the accountancy profession and the particular need to declare and uphold proper standards of conduct and performance.

- In *Bolton v the Law Society* [1994] EWCA Civ 32, the Court said 'the reputation of a profession as a whole is more important than the fortunes of an individual member of that profession'.

  As the principal function of sanctions is not punitive but to protect the public interest, it follows that 'considerations which would ordinarily weigh in mitigation of punishment have less effect on the exercise of this jurisdiction.'

Therefore, the key principles upon which an effective sanctions policy should be based are as follows:

- As stated clearly in the Sanctions Guidance and Sanctions Policy, 'the primary purpose of imposing sanctions … is not to punish, but to protect the public and the wider public interest'.

- The imposition of a financial penalty is, in itself, inadequate, and should always be accompanied by a sanction such as a reprimand or conditions. In this way, the combination of sanctions makes clear the gravity of the breach, and the response considered appropriate to protect the public.

- As stated last year, in our comments concerning the FRC's proposed audit

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enforcement procedures, the Sanctions Policy should adopt a 'bottom up' approach which, in our view, is best practice in relation to disciplinary matters. A 'bottom up' approach to sanctioning assists in determining a proportionate sanction (or combination of sanctions), and helps to ensure that both proportionality and fairness are apparent. This approach also provides a means of identifying the appropriate sanction (or sanctions) to afford protection to the public, which might include a deterrent (to the party who committed the breach and to other parties).

- In order for a deterrent to be effective, and for the public to be adequately protected, publicity of the enforcement process and any sanctions imposed must be sufficiently clear and timely. Publicity should only be withheld in exceptional circumstances, and only to the extent required by the Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR), ie limited to the identity of the person sanctioned.

With these principles in mind, it becomes apparent that the use of tariffs is inappropriate, as assigning a particular sanction to a particular breach as a starting point ignores the surrounding facts and circumstances, and undermines the need for proportionality and a 'bottom up' approach. A tariff-based approach would be too restrictive, as the independent decision-makers must be seen to have flexibility, and the ability to exercise appropriate judgment. A tariff approach also does not align comfortably with the statement that punishment is not an objective of the Sanctions Policy.

AREAS FOR SPECIFIC COMMENT:

In this section, we set out our response to the specific questions set out in section 5 of the call for submissions.

Question 1: Are the objectives set out in the Sanctions Guidance and Sanctions Policy satisfactory? If not, why not, and how could they be improved?

We believe that the stated objectives are correct. We particularly support the statement, in both the Sanctions Guidance and the Sanctions Policy (Audit Enforcement Procedure), that '[t]he primary purpose of imposing sanctions … is not to punish', as punishment is a matter for the courts.

Each document sets out the same four sanctions-related objectives. It is worthy of note that the first two objectives – deterrence and protection of the public - are of a different

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nature to the other two. The first implies that a sanction must be significant enough to have a deterrent effect. Therefore, like the second objective, it protects the public. The second objective adds the possibility that a sanction may serve to prevent an individual or firm from providing a certain service (or services) to the public.

The fourth objective – to uphold proper standards of conduct – is largely a product of the first two. This objective (as with the third) is only met if there is appropriate transparency, and the sanctions meet the other better regulation principles – particularly that they are targeted, proportionate and consistent.

Question 2: Is the Sanctions Guidance/Sanctions Policy satisfactory and fit for purpose in current circumstances?

Broadly, we agree that the Sanctions Guidance and the Sanctions Policy (Audit Enforcement Procedure) are fit for purpose. However the approach to determining sanction makes no reference to a 'bottom up' approach to determining the sanction (or combination of sanctions) that is proportionate and achieves the stated objectives.

Panels imposing sanctions are under a duty to act proportionately. Any interference with a member's right to practise in their chosen profession will engage the right to respect for private and family life, which is protected by Article 8 of the European Convention on Human Rights. It was established in the case of *Huang v Secretary of State for the Home Department* [2007] UKHL 11 that any interference in a member's professional standing and ability to practise must be no more than the minimum necessary to uphold the public interest. The Committee must strike a balance between the rights of the relevant person and the public interest.

Acting proportionately requires panels to consider all the sanctions available to them in ascending order of severity. Panels should start with the least restrictive sanction, and proceed until finding the order that is sufficient to address the member's conduct or misconduct. This is the case whether the finding was made because of a need to protect the public, the maintenance of public confidence, or the need to declare and uphold proper standards.

Therefore, we believe improvements to the guidance are required and, once completed, decision-makers should always be provided with that guidance. The improved guidance should not include any form of tariff or prescribed range of penalties. Assigning a particular sanction (or range of sanctions) to a particular type of breach undermines the need for proportionality and a 'bottom up' approach. A tariff-based approach would impede independent decision-making, and the exercise of appropriate judgment. It may also obscure, to some extent, the fact that punishment is not an objective of the Sanctions Policy, and that the protection of the public is paramount.

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With regard to the sanctions themselves, we believe that a declaration that the statutory audit report does not satisfy the relevant requirements (paragraph 16(f) of the Sanctions Policy (Audit Enforcement Procedure)) is not a sanction. This is an administrative measure, which may be necessary to provide appropriate transparency and to protect the public; but it is a measure that is not dependent upon the outcome of an investigation or the decision-making process. We acknowledge that this measure is included along with sanctions under article 30a of Directive 2014/56/EU of the European Parliament and of the Council ('the EU Audit Directive'); but in the SATCAR (regulation 5(d)) it is combined with an order to forego or repay fees payable. Therefore, the Sanctions Policy would be clearer if the provision for such a declaration was removed from the list of sanctions, and explained elsewhere.

Question 3: In connection with the matters set out in relation to question 2 above, given the type and range of case with which the FRC is concerned, adoption of a tariff or detailed guidelines would be difficult. Therefore, if respondents think some form of tariff or guideline would be appropriate, the Review Panel would welcome any observations on the appropriate form and content they, or some other form of guidance, should take.

As we have already expressed our objections to any form of tariff system, we have declined to answer this question 3.

Question 4: In imposing sanctions should decision-makers seek to place any particular focus on entities rather than individuals or vice versa?

ACCA has consistently held core values of integrity and accountability. Therefore, we believe that the focus of an investigation and enforcement process should be on those seen as responsible – the entity, an individual (or individuals) or both.

There will be occasions on which a firm's systems or structures encourage, require or allow a breach, and the investigation and enforcement process must distinguish between such a systematic failure and the actions of a rogue individual. Nevertheless, where the focus is rightly on the firm the responsibility of the individual must also be considered, and vice versa. The FRC must stand willing to challenge a firm where the firm's systems have allowed a rogue individual to commit a breach, and also to challenge individuals who control or exercise significant influence within firms.

Of course, the FRC cannot investigate and sanction a client company under its enforcement procedures. Its remit extends only as far as those involved in the finance function of companies. But where an audit firm (or individuals within it) are subject to

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investigation, the responsibility of the finance director in the client company should not be overlooked.

Question 5: In relation to financial penalties should the FRC establish some starting point in respect of both individuals and entities?

The starting point for a financial penalty must be zero. A 'bottom up' approach to sanctioning allows a combination of sanctions, and it must be acknowledged that a public reprimand (or severe reprimand), for example, will probably have a greater deterrent effect than a financial penalty (which should not be set with the objective of punishing the entity or individual). Nevertheless, the level of any fine should be meaningful but proportionate. The appropriateness of the fine must be considered from the perspective of the accountancy profession, and also of the general public.

Question 6: To what extent do current sanctions meet regulatory objectives? If they do not, why is that?

For a regulator focused on improving standards and protecting the public, the range of sanctions available to decision-makers is satisfactory. However, Appendix 3 to the call for submissions illustrates that there has been a steady flow of breaches in recent years. This might suggest that the sanctions being imposed have been less effective in meeting the regulatory objectives than intended.

We suggest that the Sanctions Guidance and Sanctions Policy could provide sharper alignment between the regulatory objectives and the sanctions available. The quality of decision-making will then be apparent through transparent publicity around sanctions, and a clear understanding of the need for publicity will also focus the minds of decision-makers on being seen to meet the regulatory objectives. We believe that the importance of such publicity is illustrated in paragraph 19(vii) of the Sanctions Policy (Audit Enforcement procedures), which states that the sanctions approach should include: '[giving] an explanation at each of the six stages above, sufficient to enable the parties and the public to understand the Decision Maker's conclusions'.

Question 7: In relation to financial penalties are they being set at the right level?

It is not for ACCA to answer this question in such a way as to undermine the judgment of decision-makers. However, we have responded to other questions (and in our general comments) above with regard to key principles upon which an effective sanctions policy should be based. We should also reiterate here the importance of sanctions guidance and transparency throughout the enforcement process.

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There is a risk that a more robust sanctions procedure may simply be translated into higher financial penalties. However, the satisfaction of public demand in this way (if any) would be short-term. It is for the Sanctions Policy, and transparency of the enforcement process, to demonstrate that regulatory action taken is proportionate, well-reasoned and in the public interest, rather than simply satisfying the perceived demands of the public.

Question 8: If respondents think that financial penalties are too low is this because:

a) **failures of the type covered by the procedures require greater censure than is currently given;**

b) **they are not commensurate with the revenue or profit earned by accountancy/audit firms or with the impact of the failures being sanctioned;**

c) **they are insufficient to incentivise either high quality audit work / compliance with rules, regulations and standards;**

d) **they do not promote public confidence; or**

e) **some other reason?**

It is not appropriate for us to respond to this question, given our response to question 7 above. We have focused our earlier responses on being clear about the principles for an effective sanctions policy, and the need for clear and effective guidance for decision-makers, and effective publicity of any sanctions imposed.

Question 9: What are the key elements in achieving effective deterrence?

Within the structure of an effective sanctions policy, it is for the decision-makers to determine the level of sanction that is sufficient to provide an effective deterrent. However, transparency (including clear publicity of findings and sanctions), while not in fact a sanction, has a significant deterrent effect (through its inevitable impact on reputation), as well as demonstrating fairness. Therefore, appropriate transparency promotes respect for the regulatory process. The withholding of publicity should only be in exceptional circumstances.

Within the range of sanctions available, the removal of the right to practise in certain areas and the imposition of conditions are primarily for the protection of the public. But

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these measures also act as deterrents, and they are perceived as such by accountants and auditors. Within a 'bottom up' approach to sanctioning, these protection measures might be seen as a minimum level of sanction. However, their deterrent effect should also be assessed, especially when combined with a public reprimand, for example.

In respect of financial penalties, the deterrent effect of financial loss alone is difficult to predict, but is unlikely to be significant unless the level of financial penalty is punitive. Apart from this being perceived as contrary to the sanctions objectives, such an approach could be seen as unfair, as any fines on corporations are ultimately borne by the shareholders.

Question 10: Do current sanctions in fact promote or incentivise good behaviour and promote public confidence?

We suggest that this is, in fact, an inappropriately worded question. It may be argued that no auditor intends to perform a bad audit, and so it is not the purpose of sanctions to 'promote or incentivise good behaviour'. However, with regard to promoting public confidence, the Review Panel should try to establish whether robust and well-publicised sanctions are being imposed, and whether those who impose the sanctions are seen to be independent decision-makers. These elements combine to promote respect for the regulatory framework, which will serve to incentivise the regulated community to act diligently and appropriately.

Question 11: Should there be greater use of non-financial sanctions such as:

a) the imposition of conditions on practice or exclusion either of the firm or the practitioner from practice in particular areas or requirement for further training; and/or

b) an order for some form of restitution?

The non-financial sanctions suggested are already available under the Sanctions Policy and the SATCAR, although they have not been used recently. In employing a 'bottom up' approach to sanctioning, non-financial sanctions could be used (perhaps in combination with financial sanctions) to provide more proportionality and better protection of the public. Guidance provided to decision-makers should encourage them to explore the options available to them.

Under the Sanctions Policy and the SATCAR, a decision-maker may order a respondent to take action to mitigate the effect of a breach of relevant requirements. The other form of restitution available is the waiving or repayment of fees that would

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otherwise be payable. While the return of fees would usually be seen as fair and reasonable, care should be taken to ensure that such sanctions do not send the wrong message, as it is difficult to argue that mere restitution either acts as a deterrent or provides a measure of protection to the public. In addition, seeking restitution would usually be considered to be a civil matter, to be dealt with through the courts.

Question 12: The Sanctions Guidance in support of both Schemes contains provision for a discount for admissions and/or settlement; see paragraphs 57 to 61 of the Accountancy Scheme Sanctions Guidance, as does the Sanctions Policy; see paragraphs 73 to 77. Are these provisions:

a) operating satisfactorily; or

b) inappropriate, and, if so, why?

We feel that we are not close enough to the sanctioning process to be able to assert that the provisions for discounting a sanction are operating satisfactorily. In future, we should like to see detailed published reasons for the level of sanction, using a 'bottom up' approach, which would then make the impact and reasonableness of any discount clearer to the public.

However, in principle, some provision to be able to discount a sanction is appropriate, as it allows the process of determining sanction to demonstrate proportionality – weighing the sanction against the potential costs of protracted investigations and hearings. However, care should be taken to ensure that the public interest of such discounting is evident, and that the deterrent effect (and the protection of the public) is retained (and seen to be so). Therefore, a discounted sanction should only be determined where appropriate insight has been demonstrated, and there should never be any suggestion that the discount came about simply as the result of a 'deal' between the parties.

Following the decision in *Bolton v the Law Society* (quoted above), any discount to a sanction should not be related to remorse or the personal circumstances of the individual (eg paragraphs 64 (j) to (l) of the Sanctions Policy (Audit Enforcement Procedure)[1]) in such a way as to suggest that the discount is in respect of a mitigation of the *punishment*.

[1] These paragraphs state that matters that should be taken into account when deciding the sanction or combination of sanctions to be imposed include:

- that a Statutory Auditor held a junior position;
- a Statutory Auditor's personal mitigating circumstances;
- that a Statutory Auditor or Statutory Audit Firm has demonstrated contrition and/or apologised for the breach of the Relevant Requirements.

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Question 13: Are there some sanctions which could usefully be imposed which are not currently available?

We are not aware of any useful sanctions that are currently unavailable. However, it would appear that only a limited range of available sanctions has been used in recent years. This suggests that improvements could be made to the sanctions guidance. But we also believe that the sanctions-related objectives would be better met if the Sanctions Policy was to require a 'bottom up' approach.

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