Financial Reporting Council

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Analysis of responses to consultation paper on Sanctions Guidance to Tribunals

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

ANALYSIS OF RESPONSES TO CONSULTATION PAPER ON SANCTIONS GUIDANCE TO TRIBUNALS

(as at 4 December 2012)

Issue	Consultation Responses	FRC response	Para No. (in latest draft) and Comment
The need for Sanctions Guidance	There was broad support for the development of Sanctions Guidance of the nature proposed		
The conceptual approach	Overall, respondents agreed that when imposing sanctions, Tribunals should be seeking to; • Deter members of the profession from committing 'misconduct'; • Maintain public confidence in the profession; • Uphold proper standards of conduct and behaviour by members of the profession.	The FRC has reflected these objectives in the revised Sanctions Guidance.	Para 7
	Many respondents thought that the draft guidance was too prescriptive and that the guidance should emphasise the discretion that lies with the Tribunal that has heard the Complaint.	The FRC has amended the draft Sanctions Guidance to emphasise the Tribunal's discretion.	
	Some respondents urged the FRC to recognise the difference between "bad work" and "bad behaviour". They argued that, generally, fines would not deter "bad work" – such as failures to comply with	This issue is addressed by the amendment to the definition of misconduct (in the Scheme) and by the discussion in the guidance of the factors to be taken into	

	professional standards or well-intentioned errors of judgement. Others contrasted "sins of omission" and "sins of commission" Respondents noted that Tribunals should consider whether a Member/Member Firm is "fit to practise". If not, mitigating factors would be largely irrelevant, and protection of the public should guide the Tribunal's exercise of its discretion.	account by a Tribunal The FRC considers that mitigating factors are relevant, notwithstanding that the misconduct calls into question whether a Member/Member Firm is fit to practise (as those mitigating factors may demonstrate that the causes of the misconduct are likely to be addressed). However, the FRC does not believe that a settlement adjustment should be applied in such circumstances.	Para 53
Misconduct	Many respondents argued that the definition of 'misconduct' in the Scheme should be amended. Respondents expressed concern that the draft guidance contemplated an adverse finding and the imposition of sanctions even though the degree of misconduct might not even constitute negligence. Many respondents criticised the definitions used in establishing 5 levels of misconduct One Respondent argued that the impact of any misconduct should be disregarded if that impact was fortuitous and unpredictable.	As respondents will be aware from the FRC's proposals to amend the Scheme, the FRC is proposing that the definition of 'Misconduct' should be amended to *"Misconduct means an act or omission or series of acts or omissions, by a Member or Member Firm in the course of his or its professional, business or financial activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual), which falls [significantly] short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession".* Given the revised definition of Misconduct, the 5 levels of misconduct are no longer appropriate and have been removed.	

The approach proposed in the Consultation Document	Respondents made a number of suggestions as to the approach that the FRC should adopt: 1. The better approach would be to start by identifying the minimum sanction that might be appropriate and then adjust to reflect the particular circumstances. This was thought to offer flexibility and be least open to criticism for lack of proportionality (whilst being less predictable). 2. Sanctions should be proportionate to the wrongdoing AND be set at the minimum level necessary to protect the public interest. 3. The guidance should a. Address those situations where more than one person/party is responsible – for example, the approach would differ depending on whether the events involved a rogue individual, a breakdown in a Firm's systems or occurred in the course of a joint audit; and b. Whether, and if so when, it would be appropriate to impose different sanctions on two or more Members/Member Firms committing the same misconduct.	The FRC has reflected upon the suggestions made and has revised the draft guidance. The guidance advises a Tribunal to reflect on the misconduct and identify the appropriate sanction and then adjust that sanction to reflect the aggravating or mitigating circumstances. The importance of proportionality is emphasised in the guidance Because the FRC is concerned to provide guidance that is of assistance to those considering making a settlement proposal, the guidance indicates the considerations that may guide a Tribunal when considering different options.	Paras 9, 15 and 16 Para 10
Aggravating and Mitigating factors	A number of respondents argued that Tribunals should take into account the severe career and reputational damage arising from the announcement of an investigation and/or a successful Complaint.	The FRC has considered the suggestions made by respondents and has incorporated many of those suggestions in	Para 48 and 49

	These already act as serious deterrents. Respondents suggested the following additional factors that the guidance could usefully include: • Self-reporting and similar co-operation should be reflected in the Tribunal's assessment – and that would be consistent with the deterrent objective of the guidance. • When considering the imposition of a sanction, a Tribunal should have regard to o the quality and extent of a Member Firm's procedures, systems and controls; o any disciplinary records; o Any external regulatory reports and/or disciplinary records; o The role of other persons involved (e.g. directors and/or senior management); o The extent of any external pressure; o Whether the individual is a primary or secondary actor (e.g. whether the Member committed the fraud or failed to identify it); o Whether the individual has shown remorse; o Whether the conduct complained of was of a continuing or one-off nature; o The seniority (or otherwise) of the practitioners involved; o Where the misconduct was the personal responsibility of 'one	the revised Sanctions Guidance.	Para 17

	bad apple' , whether the Member Firm had properly complied with ISQC 1 or whether there had been systemic incompetence • There should be no linkage between the sanction impose by a Tribunal and the approach taken or sanction imposed by another regulator.(PwC) • When considering the responsibility of a Member/Member Firm for an audit failure, the Tribunal should recognise that audits are undertaken by teams, some of whom will bear some responsibility (even if the ultimate responsibility rests with the audit engagement partner).	The FRC does not consider that a general approach should be established – each situation should be considered on its merits. This is identified as a factor to be considered by a Tribunal.	Para 17
Guidance when imposing fines	Although a number of respondents supported an increase in the levels of fines imposed (arguing that this would be in line with the approach being taken by other regulators), most respondents argued that the Consultation Paper contained an excessive focus on fines and was too prescriptive. Many Respondents argued that: 1. The approach currently being taken by Tribunals is appropriate (referring, by way of example, to the approach taken by the Tribunal in PriceWaterhouseCoopers LLP Re: JP Morgan Securities Limited Client Money). 2. Increases in fines are neither warranted nor required; 3. The deterrence effect of fines is overstated in the draft Guidance – because many disciplinary cases do not involve deliberate	The FRC has substantially redrafted the guidance when imposing Fines The FRC's views on the specific arguments advanced by respondents are set out below. 1. The FRC has taken note the approach taken in the Tribunal's decision. 2. The FRC remains of the view that that financial penalties should reflect the scale of a Member/Member Firm's wrongdoing and should enhance public confidence in the regulation of the profession. 3. A review of the disciplinary cases	Paras 23 et seq.

	or reckless behaviour; 4. The FRC should not draw on the FSA's approach to setting fines when developing its guidance, because the FSA's approach is understandably concerned with consumer detriment, disgorgement of profits obtained from misconduct/breaches of regulation, punishment as well as deterrence; 5. A formulaic approach to the calculation of fines is inappropriate; 6. The revenue/profitability of a firm should not form part of a Tribunal's approach when deciding the level of fine to impose 7. The revenue/profitability of a firm is potentially unfair and/or distorts the position – for example, a firm's non-assurance activities may have no relevance to the matters complained of and so distort the calculation of any fine. 8. The engagement fee should be the starting point when assessing the level of fine to be imposed (as that would relate the sanction to the benefit gained).	undertaken by the ADDB/FRC shows that many cases involve both accountants in business and accountants in practice. Many such cases involve deliberate or reckless conduct – not a mere failure to comply with professional standards. 4. This may be a valid comment when considering misconduct that does not involve deliberate or reckless behaviour. However, the argument does not address circumstances where improperly prepared and audited accounts have been prepared to misled investors, counterparties and the public. 5. The FRC has concluded that the imposition of a formulaic approach would be inappropriate as it would fetter a Tribunal's discretion. However, some guidance as to the considerations that a Tribunal might have in mind when beginning the exercise of assessing the level of fine to impose is desirable (not least to guide respondents considering settlement). 6. A Tribunal must be able to have regard to the revenue/profitability of a firm when deciding the level of fine to impose because a Tribunal will have to consider (i) what level of fine would give the necessary message to achieve the objective of deterrence and (ii) the firm's ability to pay the fine in question.	

	Other respondents acknowledged that some starting point is an "essential tool" when a Tribunal is considering imposing a financial penalty. They supported the use of a Member Firm's turnover as a starting point, subject to checking that such turnover was appropriately reflective of the relevant entity involved. They also advocated taking an average of the past three years turnover to ensure a balanced and representative starting point. When considering the position of individuals, the Tribunal should consider the individual's financial resources as a whole and the fact that the individual may have limited, if any, prospects of future income.	7. The FRC agrees that, when imposing a fine, a Tribunal should have regard to the structure of that firm and the area of business linked to the breach that occurred – whether it is national or regional, the extent of any activities that have no relevance to the misconduct involved. 8. The FRC does not regard this as an appropriate approach as it is unlikely to enhance public confidence in the profession. The revised draft Sanctions Guidance reflects these considerations. The revised Sanctions Guidance reflects these suggested considerations.	Para 27 Para 28
The approach to be taken to Costs awards	A substantial majority of respondents agreed that when assessing the level of fine/sanction to be imposed, any potential exposure to a costs award should be disregarded. However, where a Tribunal is contemplating imposing a fine and awarding costs, it should consider the respondent's ability to pay when deciding the costs order. A relevant factor would be whether another organisation (such as an employer or firm, or an insurer) will be responsible for any costs award.	These observations have been reflected in the revised draft Sanctions Guidance.	Para 32

Effect of settlement	Respondents agreed that settlement should be a mitigating factor – other than where a matter called into question the ability of a Member/Member Firm's fitness to practice. Others noted that a failure to settle should not become an aggravating factor as there may be legitimate reasons – such as the existence of concurrent litigation (e.g. civil claims).	These observations have been incorporated into the revised draft Sanctions Guidance.	Para 53
Other Sanctions	A number of Respondents encouraged the FRC to consider broadening the range of potential sanctions. Suggestions included: • Reprimand; • Education and/or training requirements • Organisational sanctions; • Supervision orders; • Prohibitions/limitations on taking on new clients generally/for a specified period.	Appendix 1 to the Scheme – which sets out the sanctions that Tribunals may impose - has been extended and respondents are asked to indicate if there are any reasons why it would not be appropriate to amend the Schedule in the way proposed.	
Drafting suggestions	1. Refer to 'professional' standards.		
Other Comments	1. Some respondents urged the FRC to avoid a sanctions regime that would deter entrants into the profession. 2. The guidance should address the implications of imposing sanctions on individuals working in the public sector (given that they are subject to the	1. The FRC is sceptical at the suggestion that the profession's disciplinary arrangements would deter entrants to the profession. 2. The draft Sanctions Guidance has been amended to address the position of Members in the public	

	Schemes) 3. The Actuaries Scheme should apply only to Members (and not to Member Firms)	sector. 3. Noted.	

Respondents

1. Association of Chartered Certified Accountants (ACCA)
2. Association of Regulatory and Disciplinary Lawyers (ARDL)
3. Simon Carne*
4. Chartered Accountants' Regulatory Board (CARB)
5. Chartered Institute of Management Accountants (CIMA)
6. Chartered Institute of Public Finance Accountants (CIPFA)
7. Deloitte LLP
8. Ernst & Young LLP
9. Freshfields Bruckhaus Deringer LLP
10. Grant Thornton LLP
11. Group 'A' Firms
12. Herbert Smith LLP
13. Institute of Chartered Accountants of England and Wales (ICAEW)
14. Institute of Chartered Accountants of Scotland (ICAS)
15. Institute and Faculty of Actuaries
16. KPMG LLP
17. London Society of Chartered Accountants
18. Eugene McGivern*

19. Jeremy Orme*
20. Orrick LLP
21. PKF LLP
22. PricewaterhouseCoopers LLP
23. Reynolds Porter Chamberlain LLP
24. Taylor Wessing LLP
25. Wragge & Co LLP

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