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Dear Madam

Re: **AADB – The Accountancy Scheme Review – A consultation paper**

We welcome the opportunity to comment on the Accountancy and Actuarial Discipline Board (AADB) consultation on the Accountancy Scheme Review.

At the outset we would say that we are extremely disappointed the AADB has considered it necessary to debate these proposed changes in the media[1] rather than wait until responses have been received to the consultation document and it can consider views. Providing material to the media in this way gives a clear impression that the AADB will be disregarding any views contrary to its own on these proposed changes. We hope that this approach does not signal a trend amongst any of the FRC Operating Bodies of giving the impression of having no interest in the responses to an ongoing consultation, let alone carefully weighing responses before drawing conclusions. Furthermore, the inappropriate and inflammatory language that was used reflects badly on the AADB. Any body funded collectively by listed companies, the profession and the Government should be able to organise its resources to deal with the consequences of its own errors.

[1] AccountancyAge 28 February 2008 – page 12.

We have the following general observations.

The justification for changing the Scheme
There are only two brief references in the whole of the document (paragraphs 1.4 and 5.3) to justify this review of the Scheme, which is less than three years old and has taken just one case through its full process.

The original Scheme was carefully considered when it was created, drawing upon years of experience with previous disciplinary regimes. As there is no good reason to consider that this Scheme is fundamentally flawed, this review is premature and unnecessary. Worse, many of the proposed changes appear ill thought through, with the risk that the existing Scheme is replaced with one which does not command the confidence of all the appropriate stakeholders, and which may not work in practice as well as the Scheme it replaces.

Proposed changes to the Scheme - Misconduct
We do not agree with the AADB view that any change is required to the definition of misconduct. The consultation document, paragraph 6.3, suggests that the current wording is '*unclear and may not be consistent with the Court's interpretation of misconduct*'. We are unaware of any confusion - the principles of 'misconduct' were clearly understood by the Tribunal, AADB Executive Counsel and the respondents in the Mayflower case (paragraph 5 and 6 of the findings of the Tribunal[2] - pages 198 and 199). Before changing the definition of 'misconduct' the AADB should set out the evidence of confusion which it claims is raised by the current definition.

The AADB has, in support of a change to the definition, argued that 'misconduct' is too narrowly drafted and is inconsistent with the definition used in participant schemes. However, such schemes were in existence at the inception of the AADB three years ago, when, after due and careful process, the current definition of misconduct was considered appropriate. Either the test used by the AADB should be the same as that used by the participant bodies or narrower to reflect that the AADB should only concentrate on the most serious cases.

In paragraph 6.4, it states that the AADB goal is to move towards a '*concept of censuring behaviour which prejudicially affects the status or reputation of the profession*'. We consider that this is exactly what is achieved by the current definition of misconduct and can see no justification for change.

[2] www.frc.org.uk/documents/pagemanager/aidb/PwC%20&%20Donnelly%20Judgment.pdf

Relevant conduct

The definition of 'relevant conduct' proposed is unworkable as drafted and is inconsistent with the characteristics of the AADB Scheme set out at paragraph 2.16 (i), namely, that the AADB should deal with *'matters which raise serious issues affecting the public interest'*.

The elements of 'relevant conduct' contained in paragraph 6.6 are drafted in such a way that each of the five areas can be considered individually rather than cumulatively in such a way that "relevant conduct", justifying censure, will have occurred if there has been even a minor breach in any one of five areas. The effect of this approach is that a member, or a member firm, could produce an appropriate audit report that complies with all relevant auditing standards on financial statements that comply fully with accounting standards yet, by not complying with some non mandatory guidance, is guilty of 'relevant conduct' for the purposes of the Scheme.

The present definition of misconduct is workable, clearly understood and consistent with the remit of the Scheme, and we strongly suggest that it should not be changed.

At a more detailed level, the 'relevant conduct' test has other deficiencies:

- Including guidance within the definition of 'relevant conduct' clearly signals that the AADB considers guidance to have equal importance with standards or laws. Although standards and laws have undergone due process in their creation this is not always true for guidance. Under its proposals, the AADB will be stepping into the shoes of standard setters and legislators by prescribing requirements through a disciplinary process that those standard setters and legislators have chosen not to do. This raises the serious risk that this will effectively set inappropriate standards that members will consider they have to meet to avoid being subject to the threat of disciplinary action.

- The basis of all accounting work is professional judgement. To adopt a test based on simple non compliance with *'any relevant law, charter, bye law, regulation or guidance'* and *'accounting, auditing ethical or other standard'* completely fails to recognise the complex and difficult judgements made every day by professional accountants.

- What is proposed will only result in 'box ticking processes' of professional conduct. This appears to be contradictory to the 'principles not rules' approach promoted by a number of the operating bodies of the FRC.

We consider that replacing misconduct with relevant conduct is a crucial change that lowers the bar of what is determined as unacceptable behaviour to such a degree that it arguably removes this Scheme from the principles of natural justice, and removes any consideration of the professional judgement exercised by the individual or firm in question.

The present misconduct definition recognises that all judgements have to be evaluated in context.

As drafted, proving any one of the five activities will be sufficient to show 'relevant conduct'.

- With respect to activities one and two, bringing discredit to an employer would normally appear to be a matter of employment law and not usually a matter for regulatory investigation by the AADB.

- We are particularly concerned that activities three and four are set at such a low level that almost any piece of work could probably fail the test. Inevitably, any review of professional work by another professional will highlight areas where, in the opinion of the reviewer, some aspect of the work could have been carried out in a different way. Such an opinion will inevitably be formed with the benefit of hindsight, but without as clear and complete an understanding of the circumstances at the time the original work was performed. This natural difference of view would appear to be grounds to satisfy the 'relevant conduct' test resulting in disciplinary action. Whilst the definition includes the terms 'relevant' and 'applicable' they are open to such a wide interpretation as to be meaningless.

We are also unclear as to how the 'relevant conduct' definition sits with the public interest test contained within paragraph 2.12, in that it fails to differentiate between 'serious' and 'non serious' cases.

Procedural changes
We broadly welcome the additional procedural changes proposed in the consultation document. However, we have the following comments:

<u>Preliminary enquiries</u>

- There appears to be confusion between 'serious' and 'important' issues affecting the Public Interest. There is, we suggest, a clear distinction between important and serious matters. An important matter implies that it has great significance as compared to a serious matter being of great consequence with an element of negativity or something being wrong. Within the AADB regime we consider the test to be applied before an investigation is commenced 'should be of wide importance that gives rise to serious issues of public interest'. Adopting this approach will, we believe, focus the work of the AADB onto only the very serious matters rather than matters more appropriately dealt with by the disciplinary arrangements of the Professional Bodies.

- We are concerned that the AADB consultation paper does not clearly identify what powers the Executive Counsel has at this stage. We assume that the preliminary enquiry stage will follow on from an initial investigation by one of the professional

bodies. There is, therefore, a strong possibility that the preliminary enquiry by the AADB may be duplicative of the earlier work. We are also concerned that the enquiry could stray into matters that go beyond its remit of obtaining material which would help the board decide whether there was a matter requiring investigation.

- We consider, therefore, that a more appropriate change would be to ensure that preliminary enquiries are carried out, in their entirety, by the professional bodies. This change, along with improved communication between the AADB and the relevant participating body, will preserve the effectiveness of the present arrangements while allowing the AADB to have appropriate oversight.

Decision to lay formal complaints

- We support the view that formal complaints, relevant evidence and the decision to proceed should not be the sole decision of Executive Counsel. Having a standing committee with an oversight role (the Disciplinary Decisions Committee - DDC) is one way of ensuring that decisions are properly considered and scrutinised. We suggest that the DDC should have an ongoing role in the oversight of AADB proceedings, as this will ensure that developments which naturally arise during the course of any dispute are fully and properly considered on a regular basis. We suggest that this approach will provide for more accountability than the present proposal (paragraph 6.14 (c)) which places the onus on Executive Counsel. This will also provide greater assurance to the AADB with respect to the risk of costs it may bear.

- For the DDC to be effective it will need a level of knowledge of each case beyond the bare facts presented by Executive Counsel. This will potentially be a costly process with considerably greater costs than those apparently expected by the AADB. An alternative approach might be to use a specially appointed legal expert for the review (although this expert would need to be experienced in considering such matters). We consider that this approach may give a suitable level of confidence to the AADB without imposing the level of additional cost that consideration by the DDC will incur.

- The consultation is silent on the question of costs where an investigation is terminated after laying a complaint but before the start of a tribunal.

- The consultation document is also silent on embracing the 'Carecraft procedure' for summary determinations of proceedings. We suggest that the finding of the JDS Tribunal on the BCCI case is helpful in this regard:

  '[The Carecraft Procedure] provides a most helpful and desirable route for the summary determination of cases, but in no way reduces the duty of the Tribunal to make an appropriate order on the basis of the agreed Summary of Facts'.

If the respondent wishes to invoke such process, or otherwise resolve the matter, this should be reported promptly to the DDC.

The test for delivering a formal complaint

- We are unclear about and unaware of the difficulties identified in paragraph 6.23 for delivering formal complaints. The AADB consultation paper does not provide any examples for the comment that the Board considers it "may" be a difficult test to apply. We would infer from this that it has never been a problem in practice and we do not consider that the need for the proposed change has been justified.

- The paragraph is silent about which other bodies are being referred to apart from the Crown Prosecution Service. As the CPS deals with criminal matters, whilst the AADB deals with civil cases, we cannot see any relationship between the two bodies in this regard.

- Paragraph 6.24 identifies the single test that Executive Counsel has to meet, namely, *'there is a realistic prospect that a Tribunal will find that the conduct of a Member or Member Firm constitutes Relevant Conduct*'. Paragraph 6.26 identifies that this is just one of the tests the DDC should consider. We consider that the Executive Counsel should be applying the same tests as the DDC as this will avoid inappropriate cases put before the DDC by Executive Counsel.

- Requiring the Executive Counsel to make a formal assessment of the likely outcome of a tribunal gives the impression that the Executive Counsel is investigator, prosecutor and jury. We suggest a better test is 'having prima facie evidence that an act of misconduct, which raises serious issues of public interest, may have occurred'.

- In the absence of a full list of the desirability criteria (identified in paragraph 6.27) it is difficult to comment. With those items listed we suggest that strength of evidence and possibility of criminal investigation should also be added as a minimum. However, we cannot see why the possibility of other regulatory action should be restricted to outside of the UK.

Appointment of Tribunals

- It is very important that the convenor of tribunals (paragraph 6.31) is seen as being independent. There will always be a risk that the convenor's independence will be queried, with the possible result of bringing the process into question. We would suggest that the convenor should be an independent committee of three members.

- The consultation is silent as to any right of appeal as to the decisions of the senior lawyer, for example, if potential conflicts of interest arise. We note that the process the AADB is adopting is similar to that of the Court of Appeal, but fails to incorporate the extra level of appeal one finds in the Court system.

Tribunal Chairman's casting vote

- We believe the current arrangements for decisions to be taken on a majority basis are appropriate. We do not, therefore, support the proposed changes.

- We consider that the Scheme must be clear that a tribunal cannot proceed with an even number of members, unless all parties agree that it should do so, such as in the exceptional circumstance of a tribunal member becoming seriously ill, and likely to be unavailable for a long period. In those circumstances, the Chairman should have the casting vote as at present.

Interaction between Section 507 Companies Act 2006 and the AADB Scheme
The provisions of Section 507 regarding offences committed in connection with the auditor's report, namely that any person who '*knowingly or recklessly causes a report under section 495 (auditor's report on company's annual accounts) to include any matter that is misleading, false or deceptive in a material particular*' may be guilty of an offence, came into effect on 6 April 2008.

As the AADB should only be dealing with serious issues of public interest, there may be very rare occasions where matters are subject to legal action, under Section 507, either before or during an investigation under the Scheme.

There is a concern, therefore, that evidence obtained during the pre-investigation phase and submitted to the Scheme could become subject to scrutiny within a criminal investigation, albeit that the evidence had been produced without the safeguards a criminal case has in place (for example, the right to remain silent). Legal advice to individuals who could conceivably face criminal investigation may be that they should not give any information to participating bodies and/or the AADB. This would make the work of the bodies and the AADB difficult, if not impossible.

We understand that the Government will be producing guidance (under Section 508 of the 2006 Act) for this criminal offence. It may be sensible to include, within the Scheme and/or the Government's guidance, provisions to address instances where a criminal investigation has, or is likely to be, commenced before or during the matter being considered by the participating bodies and the AADB, in particular, whether any investigation has to await the outcome of any criminal investigation with a view to being able to rule out referral of evidence obtained by the participating bodies and the AADB to

the prosecuting authorities. This approach should, we suggest, provide for the bodies and the AADB to carry out their work unhindered.

Costs

One of the more objectionable proposals in this consultation is that relating to changes in the costs regime.

We support the need for the AADB to be able to investigate issues, without fear of costs sanctions, and proceed to a tribunal, where appropriate. However, it is fundamental justice that there is a proper balance. A regulator should not be able to proceed with total costs impunity regardless of the circumstances.

We strongly object to the AADB using the test of 'misfeasance' when considering whether costs should be awarded. This sets the unrealistic bar of the AADB acting in bad faith in bringing a complaint before an award of costs will be considered. This proposal appears to be a 'knee jerk' reaction to the costs award made against the AADB in the Mayflower case. As the Tribunal reported in their final findings[3] on one of the two complaints (paragraph 36.4, page 15),

'Since the circumstances which justified the abandoning of that complaint had existed for some months and did not arise because of any change in circumstances on the second day of the hearing when it was abandoned, the Tribunal's view is that the complaint should have been abandoned long before it was. Had it been so abandoned, a considerable saving of legal costs would have been achieved'.

This proposal completely misses the reason why the AADB found itself in the position of paying costs - the decision to bring the complaint forward was flawed. This position was exasperated by the fact that the progress of the case had not been subject to adequate ongoing review.

It does appear that the proposed changes to the Scheme are sending a mixed message. Does the AADB have confidence that the additional safeguards and oversight it is proposing will result in well founded complaints based on objectively assessed factual and expert evidence regularly evaluated? Or does the AADB not have such confidence? If so, this would appear to support the setting of provisions to remove any award of costs in the event a complaint fails.

We suggest that the award of costs should be based on an 'unreasonable test' that is whether the Tribunal considers that it was reasonable for the AADB to bring the complaints. The steps the AADB is proposing with respect to the change of its procedures, together with our suggested enhancements, should give it the confidence it needs that

[3] www.frc.org.uk/documents/pagemanager/aidb/PwC%20and%20Donnelly%20Costs.pdf

complaints finally brought before a tribunal, provided they have been subject to due process and brought reasonably, will not subject it to awards of costs.

Conclusion

In conclusion, we consider that many of the changes proposed by the AADB have not been properly considered and serve neither the public interest nor the profession well. We regret the inflammatory remarks attributed to the Executive Counsel, including references to David and Goliath, which are both inaccurate and inappropriate. We consider that the flaws in the proposals are so great that the AADB should withdraw them and issue a new consultation paper after further, and better, deliberation.

Please contact Peter Wyman if you require any further information. We are content for this response to be published.

Yours faithfully

PricewaterhouseCoopers LLP