Financial Reporting Council

Audit Enforcement Procedure

Early Admissions Process Policy

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Contents

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Introduction

1. This document sets out the policy of the FRC for use of the Early Admissions Process (**EAP**) in Part 3 of the Audit Enforcement Procedure (**AEP**).[1] It explains how Executive Counsel will use the EAP, and what is expected of a Respondent who is the subject of an EAP matter. The purpose is to ensure that consistent and proportionate decisions are taken, although it is recognised that this document cannot cater for every situation, and each matter must be decided on its own unique facts and circumstances. The FRC keeps its policies under review in response to changing circumstances and practical experience.

2. There may be more than one Respondent in an AEP investigation – typically the Statutory Audit Firm appointed to conduct the audit in question, and the Statutory Auditor who acted as engagement partner and signed the audit report on the firm's behalf. In this document, references to the Respondent should be read as references to each Respondent in the matter.

3. The EAP is available in suitable matters where an investigation has been opened under Part 4 of the AEP. It is a process under which a Respondent may carry out their own review of the matter, on terms agreed with Executive Counsel, and admit any breaches of Relevant Requirements identified in the resulting report (known as the EAP Factual Account). Participation in the EAP is voluntary, and subject to agreement by Executive Counsel.

4. The EAP is intended to be used in matters where the Respondent is already aware that there were deficiencies in the audit and carries out a self-review in order to establish the full extent of the deficiencies and to identify the Relevant Requirements breached as a result.

5. On receiving the EAP Factual Account, Executive Counsel takes proportionate steps to verify the information provided and any admissions made. If Executive Counsel considers that admissions made in the EAP Factual Account provide a sound basis for disposing of the matter, Executive Counsel enters into settlement discussions. If Executive Counsel considers that settlement on the basis of the EAP Factual Account would not be appropriate, or terminates the process prior to the account being provided, they can continue to investigate the matter in the usual way.

6. If the EAP is used successfully, this will lead to earlier resolution of matters, saving time and cost for all parties involved. The Respondent is also eligible to receive an enhanced reduction of any financial Sanction.

7. The EAP is intended to be used to dispose of the matter in its entirety, and the EAP Factual Account will be expected to address all of the issues under investigation. Outside the EAP, it remains open to a Respondent to agree with Executive Counsel that they will carry out their own review of one or more of the issues under investigation, at any stage, and admit any identified breaches.

1 This document adopts the definitions used in the AEP

Procedure

8. The AEP sets out the following process for the EAP:

   a. Where the Conduct Committee decides to refer a matter for investigation by Executive Counsel under Rule 8(d), the Conduct Committee sends a Notice of Investigation to Executive Counsel and the Respondent, copied to the Respondent's Recognised Supervisory Body (Rule 10(e)).

   b. Within 28 days of receiving the Notice of Investigation, the Respondent can notify Executive Counsel of their interest in participating in the EAP (Rule 21).

   c. Within 28 days of receiving the Respondent's indication of interest in participating in the EAP, Executive Counsel informs the Respondent whether they agree to the Respondent's participation. Participation is not permitted where criminal conduct is suspected (Rules 22 and 23).

   d. The deadlines for indicating interest in participating and for agreeing to participation can be extended (Rules 21 and 22).

   e. Where Executive Counsel agrees to the Respondent's participation in the EAP, Executive Counsel and the Respondent agree the relevant arrangements, including in relation to the scope and timing of the EAP Factual Account, the process for attestation to the robustness of the enquiries and the completeness of the account, and the supporting documents to be provided with the account. The agreed time for providing the EAP Factual Account will ordinarily be no longer than 6 months (Rule 24).

   f. After the arrangements have been agreed, Executive Counsel requires the production of the EAP Factual Account and the supporting documents (Rule 25).

   g. Executive Counsel may terminate the EAP at any time before receiving the EAP Factual Account (Rule 26).

   h. On receiving the EAP Factual Account, Executive Counsel can make enquiries to satisfy themselves of the accuracy and completeness of the information provided, including requiring the Respondent to provide further information (Rule 27).

   i. Having received the EAP Factual Account, Executive Counsel either enters into settlement discussions based on the account, continues to investigate the matter or decides that the Respondent should no longer be liable for Enforcement Action and issues a Notice of Closure (Rule 28).

Expressing an interest in participating

9. An expression of interest in participating in the EAP must be in writing. The expression of interest is expected to be made on a Without Prejudice basis and would not be relied upon by Executive Counsel in any Tribunal proceedings, should it not prove possible to settle the matter.

10. The time limit for expressing an interest in participating is 28 days from receipt of the Notice of Investigation. Executive Counsel will only allow extra time in exceptional circumstances, for example where the Respondent only became aware that there was an issue with the audit on receiving the Notice of Investigation or shortly before. A request for extra time should be made in writing, with reasons, before the time limit expires (unless the exceptional circumstances arise after expiry).

11. The expression of interest should include any information that would be of assistance to Executive Counsel in deciding whether to agree to participation. The Respondent should have regard to the factors likely to be considered by Executive Counsel, as set out below, when deciding what information to include.

12. Where the firm and the engagement partner are both Respondents, they may wish to discuss a joint position on participation in the EAP. If the firm and the engagement partner consider that their interests are aligned, such that they expect to be able to prepare an EAP Factual Account acceptable to both of them, they may make a joint expression of interest. If it appears unlikely that both parties will be able to agree on the conclusions and the admissions to any breaches in the EAP Factual Account, one or both of them can make their own individual expression(s) of interest.

13. Participation in the EAP is voluntary. If a Respondent decides not to express an interest in participating, Executive Counsel does not draw any adverse inference from this when deciding whether or not the Respondent has breached Relevant Requirements, and the Respondent may still be eligible for the standard reductions in financial Sanction for exceptional cooperation and early disposal under the *Sanctions Policy (AEP)*.

Agreeing to participation

14. Agreement to participation in the EAP is at the absolute discretion of Executive Counsel (other than where criminal conduct is suspected). Executive Counsel will not usually agree to participation unless satisfied that use of the EAP is:

    a. Likely to result in a sufficiently complete and accurate EAP Factual Account, leading to a significant saving of time and/or FRC resources compared with the usual investigative process, and

    b. Otherwise appropriate, having regard to the public interest.

15. In determining whether use of the EAP is appropriate, Executive Counsel considers all relevant circumstances. Factors which may be relevant include:

    a. **The number, nature and seriousness of the issues under investigation**. Use of the EAP is not permitted where criminal conduct on the part of the Respondent is suspected, and is unlikely to be appropriate where there is any indication of dishonesty, lack of integrity or reckless misconduct on their part. Use of the EAP is unlikely to be appropriate in other cases of particular seriousness, because the public interest is likely to require a full investigation by Executive Counsel in such cases.

    b. **The information already available about the issues under investigation**. Where Executive Counsel already holds significant relevant evidence, use of the EAP may not add significant value.

    c. **The scale, complexity and duration of the investigation if the EAP were not to be used**. This is relevant to the likelihood that use of the EAP will save significant time and/or resources.

    d. **The capability and resources of the Respondent (or any third party carrying out the self-review on their behalf)**, with regard to their ability to produce a complete, accurate and objective EAP Factual Account.

    e. **The availability to the Respondent of the relevant documents or information**, to the extent this may have a bearing on their ability to produce a complete and accurate EAP Factual Account.

    f. **Compliance with Executive Counsel's expectations in respect of legal professional privilege** (**LPP**). Executive Counsel cannot compel the production of information that is the subject of LPP. However, Executive Counsel will expect to be allowed access to material generated in the self-review, such as interview records. Where LPP is asserted in respect of such material, Executive Counsel will expect the Respondent to provide the material under a limited waiver of privilege allowing its use for the purposes of the FRC's functions (including the investigation and any resulting enforcement proceedings).

g. **The Respondent's regulatory record**, to the extent this may have a bearing on their ability to produce a reliable EAP Factual Account.

h. **The position of both the firm and the engagement partner** (whether or not they are both Respondents in the investigation). Input from the engagement partner may be necessary for the firm to be able to carry out an effective self-review of the audit, and conversely it may be impossible for the engagement partner to produce a meaningful EAP Factual Account without access to the material held by the firm. Further, Executive Counsel will not be assisted by conflicting EAP Factual Accounts from the firm and the engagement partner. Executive Counsel is therefore most likely to agree to use of the EAP where a joint expression of interest is made by the firm and engagement partner with a view to preparing a single EAP Factual Account. However, Executive Counsel considers each matter on its own specific facts. Where Executive Counsel agrees to joint participation by the firm and the engagement partner, it is acknowledged that the firm and engagement partner may ultimately be unable to agree on the conclusions and admissions to any breaches, once the self-review is completed.

i. **The willingness of an appropriate person to make the necessary attestation** to the robustness of the Respondent's self-review and the completeness and accuracy of the EAP Factual Account.

j. **The position of any other regulatory or law enforcement authorities with an interest in the matter**. Use of the EAP is not appropriate where it might prejudice the enquiries or actions of another authority.

16. Executive Counsel may proceed with the investigation while waiting to see whether the Respondent expresses an interest in participating in the EAP, and while considering whether to agree to participation. The extent to which Executive Counsel follows their usual information-gathering processes on the opening of the matter will depend on their assessment of the likelihood of the matter proceeding under the EAP, having regard to the information available at the time, including any previous communications with the Respondent.

Agreeing the arrangements

17. At the same time as notifying the Respondent of their agreement to the Respondent's participation in the EAP, Executive Counsel initiates discussions with a view to agreeing the arrangements for participation.

18. The agreed arrangements will be recorded in writing and are likely to cover, as a minimum:

    a. **The initial scope of the self-review**. This will usually cover all the focus areas of Executive Counsel's investigation, and might be defined by reference to entire areas of the audit(s), or specific issues within particular areas. As when deciding the focus of the investigation, Executive Counsel ensures that the scope of the self-review is proportionate, having regard to the seriousness and significance of the issues. The scope will be kept under review in light of new information or further developments and may be extended by agreement. The Respondent should notify Executive Counsel promptly if they identify new issues during the self-review.

    b. **Who will carry out the self-review**. Executive Counsel will expect the self-review to be led by an individual of suitable seniority (usually a partner). Executive Counsel will wish to be satisfied of their capability and their independence from the audit team, and also that of any other staff working on the review. Where the self-review is to be carried out or supported by a third party, Executive Counsel will expect it to be overseen by an individual of the same seniority, capability and independence within the firm, and will wish to be satisfied of the capability and independence of the third party, and may wish to have advanced sight of the engagement terms and the instructions that they are given.

    c. **The enquiries that will be made in the self-review, and the methodology for making them**. In particular:

        (i) The scale of, and approach to, the review of relevant parts of the audit file and other documentary material.

        (ii) The arrangements for searching for and reviewing emails and other digital communications. Executive Counsel may wish to have advanced sight of lists of search terms and instructions provided to reviewers, and to conduct their own quality assurance while the searches and reviews are ongoing.

        (iii) The identity of the individuals who will be interviewed and the arrangements for carrying out the interviews. Depending on the circumstances, Executive Counsel may wish to have advanced sight of interview plans or lists of questions, to attend interviews as an observer, or to carry out the interviews.

    d. **The position regarding LPP**. See paragraph 15(f) above for Executive Counsel's expectations in this regard.

e. **The arrangements for monitoring and communicating progress**. It is anticipated that Executive Counsel will require updates at least on a monthly basis.

f. **The deadline for providing the EAP Factual Account**. This will ordinarily be no later than 6 months after the arrangements have been agreed.

g. **The content of the EAP Factual Account**. This will usually include:

(i) A summary of the enquiries made in the self-review, and the methodology.

(ii) A factual account of the relevant audit work, referring to the relevant source documents.

(iii) The identification of any deficiencies in the audit work. This may include failures to carry out audit procedures properly or at all, failures to consider relevant matters properly or at all, and reaching conclusions or making judgements that were not supported by the audit evidence or were otherwise incorrect or unreasonable.

(iv) Admissions to any breaches of Relevant Requirements resulting from the identified deficiencies.

h. **The fact that the EAP Factual Account will be provided on an open, rather than a Without Prejudice, basis**.

i. **The material to be provided with the EAP Factual Account**. This might include, for example, copies of all interview records, audit workpapers, other documents and electronic communications referred to in the EAP Factual Account.

j. **Attestation by an appropriate individual** to the robustness of the self-review and the completeness and accuracy of the EAP Factual Account.

19. Attestation is a key safeguard contributing to Executive Counsel's confidence in the EAP Factual Account. If the EAP Factual Account is provided by the firm (either on its own behalf or jointly with any other Respondent), the attestation is usually made by a senior partner in the firm, for example an individual with operational responsibility for the firm's system of quality management. If the account is provided jointly by the firm and the engagement partner, the engagement partner does not make an attestation but will be expected to provide a signed statement, for inclusion in the account, indicating the extent to which they agree with the contents. If the account is provided by the engagement partner individually, they make the attestation. In any event, the person making the attestation must be a professional accountant.

20. The relevant individual attests that:

a. They have taken all reasonable steps to ensure that the EAP Factual Account is complete and accurate in respect of the matters set out in paragraph 18(g) above; and

b. They are not aware of any other related matters or relevant information of which Executive Counsel would reasonably expect notice.

21. If Executive Counsel ultimately reaches a different view as to the existence of deficiencies in the audit work or breaches of Relevant Requirements to that set out in the EAP Factual Account, Executive Counsel will only regard this as a contravention of the attestation if the findings in the account are ones that the individual could not reasonably have reached.

22. As a professional accountant, the individual making the attestation will be subject to the code of conduct of their professional body, which will include requirements to act with integrity and professional competence and due care. Compliance with these requirements is enforced by the professional bodies themselves and by the FRC via its Accountancy Scheme.

The self-review and EAP Factual Account

23. If agreement is reached as to the arrangements, Executive Counsel compels the production of the EAP Factual Account and supporting material by issuing a notice in writing. The notice will include the agreed deadline for producing the account.

24. Executive Counsel monitors the progress of the self-review under the agreed arrangements. Where necessary, the Respondent discusses with Executive Counsel the need for any extension to the scope of the self-review or to the deadline for providing the EAP Factual Account.

25. Executive Counsel keeps the suitability of the matter for use of the EAP under review, and considers terminating the process where, for example:

    a. The Respondent asks to withdraw their participation;

    b. In the case of joint participation by the firm and engagement partner, the partner withdraws their cooperation or it becomes clear that the positions of the two parties no longer align;

    c. There is unacceptable delay in progressing the self-review or completing the EAP Factual Account; or

    d. New information necessitates a significant expansion of the scope of the investigation, suggests the existence of conduct incompatible with use of the EAP (including criminal conduct) or otherwise undermines Executive Counsel's confidence in the likelihood of receiving a complete and accurate EAP Factual Account.

26. If the process is terminated, Executive Counsel no longer requires the production of the EAP Factual Account, but may still require the production of material gathered or generated in the self-review.

27. Executive Counsel retains the ability to take other proportionate investigative steps in anticipation of receiving the EAP Factual Account or to mitigate the risk that the process may need to be terminated. This may include using further notices requiring the Respondent to provide information and/or documents.

28. On receiving the EAP Factual Account and supporting material, Executive Counsel considers whether to:

    a. Enter into settlement discussions on the basis of the account;

    b. Continue to investigate the matter in the usual way;

    c. Close the matter, on the basis that the Respondent has not breached any Relevant Requirements or, if there are breaches, they are not sufficiently serious or significant to justify Enforcement Action.

29. Executive Counsel assesses both the sufficiency of the enquiries made in the self-review and the reasonableness of the conclusions reached. Where necessary, Executive Counsel takes proportionate investigative steps to test these matters, including for example reviewing key documents, dip-sampling documents reviewed by the Respondent and regarded as not probative, examining other sources of evidence not explored by the Respondent and requiring further information from the Respondent to resolve any apparent inconsistencies or uncertainties. Executive Counsel tests the judgements made by the Respondent in determining whether there were deficiencies in the audit work and whether they amount to breaches of Relevant Requirements, obtaining expert input where necessary.

30. If Executive Counsel concludes that the EAP Factual Acccount provides a suitable basis for settlement discussions, the procedure in Part 8 of the AEP applies in the usual way.

31. The *Sanctions Policy (AEP)* provides for financial Sanctions to be discounted for mitigating factors, including exceptional cooperation, and further discounted for early disposal. The *Sanctions Policy (AEP)* does not specify the level of discount available for exceptional cooperation, but in practice in matters investigated under Part 4 of the AEP Executive Counsel applies discount of not more than 15%. The *Sanctions Policy (AEP)* specifies a maximum discount of 35% for early disposal, where the matter is settled at the earliest stage. A Respondent who participates in the EAP to Executive Counsel's satisfaction is eligible for an enhanced discount of 25% for exceptional cooperation and the maximum 35% discount for early disposal, meaning that the total discount available in an EAP matter is 60%.

32. Otherwise, the FRC's policies and processes for the determination of Sanctions and Costs and the publication of the outcome of the matter apply as for any other matter that is investigated under Part 4 of the AEP.

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