Audit Enforcement Procedure

Our Approach to Audit Enforcement

Financial Reporting Council

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Contents

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1. Our purpose

1. The purpose of the FRC is to serve the public interest and support UK economic growth by upholding high standards of corporate governance, corporate reporting, audit and actuarial work.

2. The FRC is the UK competent authority for the regulation of statutory audit, by virtue of the Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR). Our proportionate regulation of audit work expects and encourages high quality by those responsible and deals effectively and fairly with cases where there are significant or serious shortcomings.

3. Our Audit Enforcement Procedure (**AEP**)[1] establishes a graduated range of responses which aim to protect the public interest by: (i) ensuring that auditors comply with relevant laws, regulations and professional standards (ii) improving audit quality through remedial measures (iii) deterring bad practice and (iv) sharing learning with stakeholders. These responses range from non-public regulatory intervention to publicised sanctions where appropriate.

4. Our approach to how we operate the AEP is essential to our work in serving the public interest and upholding high standards of audit in the UK.[2] It is vital for public trust and confidence that the FRC responds to protect the public by investigating and holding those responsible to account where appropriate. Further, proportionate and effective enforcement helps to promote UK economic growth by helping to secure a trusted and reliable audit market and corporate reporting environment.

1 This document adopts the definitions used in the AEP

2 This document is only concerned with the FRC's investigations and enforcement work under the AEP. The FRC has other regulatory frameworks and procedures, including the Accountancy Scheme, Actuarial Scheme, Auditor Regulatory Sanctions Procedure, and Crown Dependencies' Recognised Auditor Regulatory Sanctions Procedure.

2. Our core values

5. Our core values are the basis for how we undertake all aspects of our work. We want to be respected for being **effective**, **influential**, **fair** and **independent**. These values shape how we deliver our purpose and, in particular, we focus on improvement, proportionality and engagement.

6. In the context of our operation of the AEP, we consider in particular that:

An important part of being **effective** is that our work encourages those we regulate to **improve**, learn and develop their own culture of performing to high standards. To do this, regulation must offer more than setting standards, monitoring performance and holding those responsible to account. It should also help foster the right behaviours and cultures where those responsible proactively take accountability for their own improvement in the public interest.

An important part of being **fair** is ensuring that we continue to embed the principle of **proportionality** in our work. To do this, our requirements and interventions should be justified as appropriate, targeted and no more than necessary.

3. The principles guiding our approach in practice

7. Informed by our core values (as above) and the relevant principles of good regulation, we aim to ensure that our response to potential breaches of the requirements applicable to statutory audit work (Relevant Requirements)[3] is effective, proportionate, transparent, fair and consistent, and that our activities are targeted at matters in which action is needed.

   a. **effectiveness** – we use different regulatory tools in order to pursue the optimal approach for responding to cases of suspected or established breaches of Relevant Requirements. We have a decision making governance model for ensuring that matters are handled appropriately and by those with the right expertise (with a suitable level of accountability). This helps to achieve our aim of reaching proportionate and fair outcomes that serve the public interest in as timely a manner as possible, using the routes to resolution under the AEP only when necessary.

      We ensure that our investigations and actions taken under the AEP are adequately resourced, including by obtaining external input where necessary, and are overseen by appropriate decision makers to progress matters fairly and in as timely a manner as possible.

      We keep under review whether our approach under the AEP is appropriate and remains in the public interest. We use different routes to resolution in different matters to address the particular issues that have been identified.

      We work with those we regulate, the professional bodies and other regulators to achieve the right outcomes and to share learning in order to drive improvement in audit quality. We encourage those we regulate to cooperate with our investigations and routes to resolution under the AEP, reflecting exceptional cooperation with settlement discounts where applicable.

      We reflect and share learning across the FRC to ensure our approach to investigations and routes to resolution under the AEP remain as effective as possible in order to protect the public interest.

   b. **proportionality** – we respond to cases of suspected or established breaches of Relevant Requirements in a proportionate manner with a commensurate range of routes to resolution and outcomes. Our action under the AEP is targeted at key issues and when deciding on the appropriate route to resolution, relevant decision makers have regard to

3 These requirements include the standards set by the FRC in respect of audit quality management, the ethical conduct and independence of auditors and the performance of audit engagements (the International Standards on Quality Management (UK), the Ethical Standard and the International Standards on Auditing (UK), respectively). For more, including the scope and authority of these standards, see the Audit. Assurance and Ethics page of the FRC website.

the Public Interest Factors, as appended to our *Case Assessment and Allocation Policy*.[4] This will include consideration of the likely impact of any route to resolution on those we regulate.

c. **transparency** – we set out in our policies and guidance who is responsible for decision making and how we exercise our procedures and statutory enforcement powers. When an enforcement investigation is opened, we have early scoping meetings with Respondents to explain the areas of focus for our investigation. Where we resolve matters by imposing sanctions or using Published Constructive Engagement, we publish the outcomes and, where appropriate, announce commencement of certain routes to resolution under the AEP, in accordance with our Publication Policy. Through publishing outcomes, we share learning in order to explain and improve required behaviours.

d. **fairness and consistency** – we will seek to exercise our enforcement powers in a fair and consistent manner.

4 i.e. when the Designated Officer decides whether to open an enquiry under Rule 3 of the AEP and whether to refer a matter to the Conduct Committee under Rule 5, and when the Conduct Committee decides on the allocation of a case under Rule 8 (including deciding that no further action should be taken under the AEP)

4. Our routes to resolution under the AEP

8. We have a graduated set of options for resolving matters under the AEP, as set out in the table below and explained in more detail later in this document:

Route to resolution	May result in a Sanction?
Constructive Engagement	No
Published Constructive Engagement	No
Accelerated Procedure	Yes
Enforcement investigation[5]	Yes

9. The routes to resolution are supported by a suite of further policies and guidance, for the assistance of FRC decision makers and those we regulate. These documents provide greater detail on how the routes operate, including circumstances when they are most likely to be used, to ensure that we continue to reach proportionate, consistent and timely outcomes, in accordance with our core values and principles.

10. Like this document, the other policies and guidance are advisory rather than binding on FRC decision makers. Policies and guidance cannot deal with every situation, and exceptions will sometimes arise. Nothing in the documents is intended to be inconsistent with the AEP, and decision makers must proceed in accordance with the overriding requirements of fairness and natural justice. The FRC keeps its policies under review in response to changing circumstances and practical experience.

5 Including Executive Counsel's discretion to use the Early Admissions Process for suitable matters

5. Decision makers and decisions under the AEP

11. Under the AEP, the FRC Board is the decision maker for opening investigations and related matters. In practice, the Board generally delegates its decision making for these functions to the Conduct Committee, which consists of FRC non-executive directors and operates under Terms of Reference set by the Board. In accordance with the Terms of Reference, the Conduct Committee can refer decisions to the Board, and the Board can decide to retain decisions. References in this document to the Conduct Committee as decision maker include the Board.

12. Following a recommendation from the Designated Officer, the Conduct Committee will decide whether the relevant threshold is met for one of the routes to resolution under the AEP and (having regard to the public interest) will determine whether to direct that a matter be resolved through Constructive Engagement, Published Constructive Engagement, the Accelerated Procedure or an investigation under Part 4 of the AEP.

13. The person appointed as Designated Officer will ordinarily be the FRC's Executive Director of Supervision. The Designated Officer or the Board may delegate the Designated Officer functions as appropriate. Where the Designated Officer delegates decisions under Rules 4 and 5 of the AEP, it is usually to another Executive Director of the FRC (other than Executive Counsel). The day-to-day conduct of enquiries under Rule 3 of the AEP, the preparation of material for submission to the Conduct Committee under Rule 5 and the resolution of matters by Constructive Engagement or Published Constructive Engagement under Rule 8 are generally delegated to suitably qualified staff within the FRC's Supervision Division. Input from throughout the FRC is taken into account when carrying out the tasks of the Designated Officer.

14. Where the Conduct Committee directs that a matter be resolved through Published Constructive Engagement, the Accelerated Procedure or an investigation under Part 4 of the AEP, it may make a public announcement to that effect, as set out in the *Publication Policy (AEP)*. There is a presumption against announcing a Published Constructive Engagement or Accelerated Procedure matter, but a record of all ongoing Published Constructive Engagement matters is maintained on the FRC website.

15. Where the Conduct Committee directs that a matter be resolved through Constructive Engagement or Published Constructive Engagement, these processes will be overseen by the Designated Officer. If a matter cannot be satisfactorily resolved through these routes to resolution, it will be referred back to the Conduct Committee to consider the use of a different route.

16. Where the Conduct Committee directs that a matter be resolved through the Accelerated Procedure or an investigation (either from the outset, or because Constructive Engagement or Published Constructive Engagement has been unsuccessful), conduct of those matters is the responsibility of Executive Counsel, who is supported by the FRC's Enforcement Division.

17. Where an investigation is opened under Part 4 of the AEP, a Respondent may express interest in participating in the Early Admissions Process, which is designed to encourage Respondents to agree to an early settlement of the matter. The use of this process is a matter for Executive Counsel's discretion and is not directed by the Conduct Committee.

18. Where it does not prove possible to resolve an investigation by agreement with the Respondent, the matter will be referred to the FRC Tribunal. Further details on this process are set out in the AEP.[6]

19. Where it does not prove possible to resolve an Accelerated Procedure matter by agreement, Executive Counsel will refer the matter back to the Conduct Committee to decide upon the appropriate route to resolution; this decision will likely be to open an investigation.

6 Further guidance in relation to Tribunals may also be found on the FRC website

6. How the routes to resolution work in practice

Constructive Engagement and Published Constructive Engagement

20. Constructive Engagement and Published Constructive Engagement are consensual, remediation-based approaches, with the objective of agreeing appropriate actions to address the issues raised, preventing recurrence of those issues and fostering an improvement in audit quality. If successful, these processes avoid a response which results in the imposition of Sanctions. Further detail on the circumstances in which Constructive Engagement and Published Constructive Engagement are used can be found in the *AEP Case Assessment and Allocation Policy*.

21. Constructive Engagement and Published Constructive Engagement involve seeking information from the Statutory Auditor and/or Statutory Audit Firm about the audit work conducted and the issues underlying the suspected breach of a Relevant Requirement.

22. Having regard to the available information, the Designated Officer will then seek to agree appropriate remedial actions with the Statutory Auditor and/or Statutory Audit Firm, with a view to: rectifying any breach and any adverse consequences thereof to the extent possible; and preventing the recurrence of the issues which resulted in the suspected breach of one or more Relevant Requirement(s), and to foster an improvement in audit quality. Enquiries are proportionate and targeted to obtain sufficient information to identify the relevant quality issues.

23. Enquiries are carried out in a timely manner in order to resolve the issues as soon as possible and in a shorter timeframe than an investigation would ordinarily take.

24. The Designated Officer may not impose or agree a Sanction under these processes. Instead, resolution may take many forms, including but not limited to any of the following: reviews of firm audit procedures; modifications to firm-wide audit procedures; staff training; written advice; and/or warning letters, discussion or correspondence with the individual Statutory Auditor and/or Statutory Audit Firm; and/or (in the case of Published Constructive Engagement) the payment of the FRC's costs.

25. The Designated Officer usually expects to recover the FRC's costs of Published Constructive Engagement in full, but the payable amount is capped at the total gross audit fees (and any relevant non-audit fees) charged by the Statutory Audit Firm or Statutory Auditor (including VAT) for the relevant financial year or years. The Designated Officer may waive the requirement to pay costs where appropriate.

26. Constructive Engagement will only succeed with the full cooperation of an audit firm. If a matter is not or cannot be resolved satisfactorily, it will be referred to the Conduct Committee for a decision on use of another route to resolution. As part of its oversight role, the Conduct Committee is provided with information about cases resolved via Constructive Engagement.

27. Although we do not publish individual outcomes of Constructive Engagement, we communicate themes and learnings to audit firms and share insights with accountancy bodies (for circulation to their members), other regulators and other teams within the FRC, who feed the results into their work.

28. Published Constructive Engagement works in the same way as Constructive Engagement but for matters where this is the more appropriate route to resolution, the outcome will be published by way of an active record of such matters on the FRC website. As above, in certain matters, this may be an appropriate alternative to an investigation but still results in a robust outcome, which meets the needs for deterrence, transparency and / or learning to benefit other firms and the profession.

29. We expect that the range of matters suitable for Published Constructive Engagement will be more limited than those suitable for Constructive Engagement and only where it is considered necessary to publish the outcome for the purposes of deterrence, transparency and/or education. Matters suitable for Published Constructive Engagement will concern suspected breaches of Relevant Requirements of a relatively low intrinsic potential seriousness, or where it is otherwise in the public interest and in accordance with our regulatory purpose to use this route to resolution.

Accelerated Procedure

30. Further detail on how this procedure operates can be found in the *Accelerated Procedure Policy*. In summary, this procedure will be shorter than an investigation under Part 4 of the AEP, because it will be based on information already available to the FRC at the point an Accelerated Procedure matter is opened and will not require significant further investigation by Executive Counsel.

31. The information used in an Accelerated Procedure matter (referred to in the AEP as the Relevant Information) is most likely to consist of the results of an FRC AQR report, a self-report of a breach submitted by the Statutory Audit Firm, or the findings of another regulator or public body.

32. Executive Counsel will take proportionate steps to validate the accuracy and sufficiency of the Relevant Information before using it as the basis for proposing breaches and Sanctions. This may, where necessary, include obtaining further information using the available information-gathering powers, to the extent consistent with the aims of this procedure. The Respondent is also eligible to receive an enhanced reduction of any financial sanction.

33. Where Executive Counsel enters into settlement discussions based on the Relevant Information, it is always open to the Respondent to decline to accept the proposed breaches and Sanctions, on the understanding that this may result in the Conduct Committee referring the matter for investigation under Part 4 of the AEP.

34. The aim of this procedure is to encourage resolution of a matter in a timely and proportionate fashion, without significant further investigation, which will be of benefit to both the FRC and Respondents in terms of saving time and cost, whilst still resulting in a robust outcome that protects the public interest. The Respondent is also eligible to receive an enhanced reduction of any financial sanction.

Enforcement investigation

35. Where an investigation is opened under Part 4 of the AEP, the investigation is conducted by an in-house team of lawyers and forensic accountants, overseen by Executive Counsel.

36. The formal scope of an investigation is determined by the Conduct Committee when it decides to open one. The Notice of Investigation typically specifies the audits to be investigated by reference to the audited entity and the audit years concerned. Once an investigation is opened, the FRC's Enforcement Division will review the matter and define the areas of the focus for the investigation. A scoping meeting with Respondents is typically held within one month of the Notice of Investigation being served. The meetings are designed to explain the focus of our investigations, identifying the areas of the audit that will require further enquiry, and (where relevant) to explain our investigation process and expectations. Those areas of focus are reviewed throughout our investigations to ensure that they are targeted to the issues and are proportionate. Any changes in focus are communicated to the Respondents. A change to the formal scope of an investigation (such as adding another audit year or a Respondent), as opposed to the focus areas within that scope, requires a decision by the Conduct Committee.

37. Further information is obtained from Respondents and third parties by using targeted and proportionate information requests and (where appropriate) interviews. Executive Counsel encourages Respondents to cooperate with information requests and interviews (and to volunteer information where appropriate) in order that investigations can be conducted in as timely a manner as possible. Instances of exceptional cooperation are eligible for settlement discounts, as set out in the *Sanctions Policy (AEP)*.

38. Throughout the investigation process and to the extent possible and appropriate, measures are put in place to reduce the impact of regulatory proceedings on individuals, whilst ensuring that our investigations are robust and protect the public interest. Executive Counsel keeps under review whether the Respondents (including the Statutory Auditor) should remain subject to an investigation and be liable for Enforcement Action.

39. It will often be appropriate for Executive Counsel to obtain specialist expert advice (either externally or from the FRC's internal resources) on matters relating to the audit and its performance. Specialist expert advice assists Executive Counsel in ensuring that an investigation is focused on the issues and that the relative seriousness and significance of the breaches is examined by an independent person, which helps to ensure that our investigations are as robust and fair as possible.

40. At the conclusion of the investigation stage, Executive Counsel will issue a Decision Notice setting out any alleged breaches of Relevant Requirements and proposed Sanctions. If the findings and Sanctions are accepted by the Respondent(s), the issuing of the agreed Decision Notice is subject to approval by an Independent Reviewer. The outcome is usually published.

41. Where Executive Counsel does not consider that a Respondent should be so liable, the matter will be closed without further action. Executive Counsel therefore keeps investigations under review in order to ensure that they are closed without further action (where appropriate) in a timely fashion.

42. Executive Counsel will make reasonable and appropriate efforts to resolve a case by way of agreement – and will expect Respondents to cooperate with our investigations and to seek an agreed outcome. At an appropriate stage in an investigation therefore, Executive Counsel may invite a Respondent to enter into settlement discussions. Agreeing a settled outcome will usually be a more proportionate, cost-effective and timely way of resolving a case for all parties.

43. Executive Counsel encourages all Respondents to engage in an investigation in a transparent, open and cooperative manner. As set out in the *Sanctions Policy (AEP)*, significant discounts for early settlement and exceptional cooperation are available where such behaviour is demonstrated. When proposing breaches of Relevant Requirements, Executive Counsel considers any expert advice and the public interest in deciding which breaches to allege. Executive Counsel will seek to ensure that proposed breaches are fair, evidenced and proportionate, and that they reflect sufficiently the serious or significant shortcomings identified in the audit.

44. If the matter is unable to be resolved by agreement, the case is referred to the FRC Tribunal.

45. At all stages throughout an investigation, but particularly at key decision points under the AEP, Executive Counsel considers whether the Respondent should be liable for Enforcement Action, taking into account all the circumstances of the case. This includes considering (at an appropriate stage of an investigation) whether the matter may be more suitable for an alternative route to resolution and (where required under the AEP) referring the matter back to the Conduct Committee accordingly.

46. Sanctions may take the form of financial or non-financial and are intended to protect the public interest by deterring misconduct, upholding professional standards, and ensuring accountability and reinforcing ethical behaviour in the profession.

47. Sanctions are proportionate and targeted to address the breaches of Relevant Requirements established by the investigation. Executive Counsel considers the public interest in proposing Sanctions and the *Sanctions Policy (AEP)*, under which they may be adjusted for aggravating or mitigating factors, acknowledging the balance between achieving a robust regulatory outcome which protects the public interest whilst acknowledging the impact of regulatory action on individuals and the market.

48. In particular, non-financial sanctions play a key part in our role as an improvement regulator through identifying the reasons for breaches and assessing not only whether measures are needed to prevent recurrence, but also whether any measures already implemented have proven effective.

49. For investigations opened under Part 4 of the AEP and for Accelerated Procedure cases, in addition to Sanctions, the FRC's expectation on costs is that, where breaches of Relevant Requirements are established, it will be in the public interest, fair and equitable for Respondents to bear the whole cost of the investigation and any subsequent proceedings. Where not all of the breaches are proven, subject to the restriction at Rule 165, the Tribunal should make such costs orders as it considers appropriate, having regard to the factors at Rule 164. As the FRC is discharging its responsibilities as a regulator of the audit profession in the public interest, in conducting investigations and bringing proceedings under the AEP its position is not comparable to that of a party to ordinary civil litigation.

50. Typically, and in accordance with the *Publication Policy (AEP)* and our statutory framework, enforcement outcomes are published. Publication supports the transparency principle by informing the wider public of breaches of Relevant Requirements and disciplinary actions and is also key to our role as an improvement regulator. Publication encourages auditors to learn and to develop a culture of performing to high standards, which serves the public interest.

51. Executive Counsel is supported through the publications process by the FRC's Legal Services Team. Representations from Respondents and third parties identified in any intended publication are sought in order to ensure that any publication is fair, accurate and proportionate. We aim to achieve publication as soon as possible, once an outcome has been agreed.

Early Admissions Process

52. Further detail on how this process operates can be found in the *Early Admissions Process Policy*. In summary, the Early Admissions Process is an option available in suitable matters where an investigation has been opened under Part 4 of the AEP and under which a Respondent may carry out their own objective and critical self-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 Early Admissions Process is voluntary, and subject to agreement by Executive Counsel.

53. The Early Admissions Process will be suitable for matters where the Respondent is aware of deficiencies in the audit before an FRC investigation is opened and is prepared to make admissions at an early stage in relation to those deficiencies. Where the Early Admissions Process 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. This is therefore a means of achieving a proportionate outcome in a shorter timeframe than would be ordinarily expected under an investigation.

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