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28 December 2011

**My public response to the consultation on the Sharman Inquiry on Going Concern and Liquidity Risks: Lessons for Companies and Auditors Preliminary Report and Recommendations of the Panel of Inquiry – Nov. 2011.**

Sharman report para 5 - I concur with the facts set out here. I agree with the Recommendation 1 but would point out that the FRC and FRC/AADB Boards have always had the power to investigate accounting concerns in any auditor they chose to in the public interest. I recently brought this to the attention of BIS Minister Ed Davey MP in my letter when referencing their rules – see pages 33-36 in this file. The fact is that whilst the FRC has the powers to investigate their Boards did not in high profile cases – such as PwC at Northern Rock, PwC at Lloyds/HBOS, Deloitte at RBS, and the “forensic investigation” by KPMG at HBOS following Paul Moore’s

whistleblowing and evidence to the TSC in 2009 – consciously determined not to do so. I found and find this astonishing.

If the FRC is to promote BOTH investors/market confidence AND build trust and confidence in the conduct of the accounting profession in the public interest then it must act to investigate (within its powers) those “public” cases – irrespective of the outcome. Whilst it is understandable that the Panel has not set out to determine in any particular case whether forewarning of failure should or should not have been given I expect the Panel would agree that unless one properly investigates actual cases, to properly inform for any lessons learned as well as any appropriate regulatory and disciplinary actions, then too often “speculative” retrospective reasons cloud the reality of contemporaneous evidence.

For this reason I recommend that the Panel consider carefully the completeness of what changes it recommends to the FRC and HMG in such circumstances. It behoves the FRC, in my view, to take positive actions to avoid any sustainable public perception that they have been wilfully blind to gather further traction or momentum. Another FSA regulatory nightmare is not what is needed again.

**Recommendation 2** : I would not consider myself sufficiently experienced and/or competent to comment on this

recommendation beyond observing that there is clearly an expectation gap between the “professionals” and the “99%” which needs prompt and significant attention. This ought to be a central concern of the Panel and the FRC when it provides its final recommendations in this crucial area.

**Recommendations 3 / 4** I wholly agree with the comment *“Investors generally think that both solvency and liquidity are important considerations in the going concern assessment and want to know that the risks associated with both are properly managed.”* I know from a constituents case that this subject, with both liquidity and solvency aspects are very important, and rightly so for both directors AND auditors in the UK. I agree with the substance of your Recommendations 3 and 4.

**Recommendation 5**

I would not consider myself sufficiently experienced and/or competent to comment on this recommendation but on the face of it that does make sense. I would add that in a similar vein I, and I know others, were glad to see that the FRC re-issued in July 2011 its opinion that a “True and Fair” view was central in its **primacy** guidance to auditors and directors, rather than “box ticking”.

**Now addressing the Questions put**

**Question 1** : Overwhelmingly yes in everyone's interests

**Question 2** : My responses to the five Recommendations are as set out above

**Question 3** : Apply to all companies required to file statutory financial statements with the UK Companies Registry. HMG and the FRC should be “encouraging appropriate business behaviours” everywhere in our society in the UK.

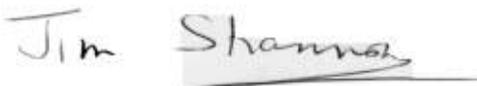
**Question 4** : There is, in my view, compelling logic and evidence as to why there should be a separate financial reporting and auditing regime for banks.

**Question 5** : My overall impression of the Inquiry and Report was very good but I hope the Final Report now gives some further thought to the wider public interest matters I have raised earlier in my submission. I do recognise that “subject matter experts” can often give “insufficient weight”, or worse unintentionally overlook this “public interest”, as they work through the plethora of” evidence and “vested interest” submissions while “Joe Public” submits nothing. I urge you to consciously consider this when finalising your report and recommendations on this key subject for investors /public – who are of course investors in their pensions etc.

Note: I am concurrently making a submission to the BIS/FRC Consultation on the Proposals to Reform the Financial Reporting Council and will, as part of that Submission, also include the series of Minister Davey / Shannon MP letters which follow providing some further context and evidence for my comments here.

I look forward to reading your final report and recommendations in February/ March 2012.

Yours faithfully,

A handwritten signature in black ink that reads "Jim Shannon". The signature is written in a cursive style and is positioned above a horizontal line.

Jim Shannon MP for Strangford

#### Correspondence exchanges

Pages 6-16: My letter to BIS Minister Davey dated 19 Sept. 2011

Pages 17-18: Minister Davey response dated 22 October 2011

Pages 19-28 : My follow up letter dated 15 November 2011

Pages 29-30 : Minister Davey response dated 8 December 2011

Pages 31-40 : My follow up letter dated 21 December 2011



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Minister      Mr Edward Davey MP  
Employment Relations, Consumer and Postal Affairs  
Department of Business, Innovation and Skills  
1 Victoria Street  
London  
SW1H 0HT

19 September 2011

Dear Mr Davey

Further to my letter dated 16 May 2011 I have no record of any reply from you. Can you please provide a copy if it has been sent already, and if not may I ask when I may receive your reply as the new parliamentary year commences.

During the summer recess I have also had the opportunity to read

**(1)** the minutes of the FRC Board meetings on this subject matter. The first public record was in the FRC Board minutes some two years ago on 6 October 2009 where at point 4.2 they record *“The Board commissioned the preparation of a paper, for consideration at its next meeting, providing an analysis of the strengths and weaknesses of the FRC’s current role and responsibilities (drawing also on the conclusions from the ongoing review of the FRC’s effectiveness) together with options for more effective achievement of the FRC’s objectives if it were possible to start with a clean sheet”*.

Further references are in the FRC Board minutes on 8 December 2009 (point 6.3), 3 February 2010 – AADB -(Point 3.1) , and then on 20 April 2010 (Point 4.1) the FRC Board minutes record at 4.1 *“Full proposals should be put to Government as soon as possible following the election on the FRC’s status and powers”* and *“an agenda setting paper on the future of accounting and audit reflecting the lessons of the crisis should be prepared”*, 25 May 2010 (point 3.1) , 15 July 2010 (Point 3.1) , 5 October 2010 (Point 2.1) , 7 December 2010 (Point 2.1 and 3.1), 3 February 2011 (Point 2).

No Board minutes have been published for the last six months on the FRC website and their annual FRC Open Day.

(2) the letter from the FRC Chair Baroness Hogg to the Chair of the House of Lords Economic Affairs Committee Lord MacGregor (dated 30 June 2011) in response to their March 2011 report on the auditors.

In particular I note Baroness Hogg states

*“We welcome the Committee’s support for the need to address the fragmentation of audit regulation and the FRC’s powers. We strongly believe that our current structure should be simplified , not least to reduce the risk of overlapping and disproportionate regulation.....etc.*

***Working with the Department of Business** and in consultation with the profession and other stakeholders **we will publish our proposals for FRC reform shortly** and we hope that they will address the Committee’s concerns about the regulatory architecture in this market. The proposals are aimed at strengthening and simplifying the FRC’s role and are designed with the following outcomes in mind ....etc “*

which of course followed the FRC written submission to the House of Lords Committee in September 2010 when in paragraph 1.6 the FRC submission concludes

*“An unambiguously robust and independent regulatory oversight of the audit profession would ensure a speedier response to risks, an increased focus on audit quality and, ultimately, enhanced market confidence in the role and value of audit.”*

and then at para 2.8 *“In **considering behaviour and culture** within the firms, the AIU has identified a number of instances of firms failing to apply sufficient professional scepticism in relation to key audit judgments. This lack of scepticism may manifest itself in a number of ways: over-reliance on management representations; failure to investigate*

*conflicting explanations; failure to obtain appropriate third party confirmations; or seeking to obtain evidence that corroborates, rather than challenges, judgments made by client management.... 2.9...2.10 etc,,"*

I expect since my 16 May 2011 letter you will also have had the opportunity to read that the FRC/Professional Oversight Board have recently reinforced this in their Annual letter to the Secretary of State on 21 July 2011 and underpinned their evidence from their 2010/2011 Audit Inspection Unit reports. You will probably have read the Daily Telegraph coverage of this on the 26 July 2011

<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/8661047/Biggest-audit-firms-hit-by-scathing-regulators-verdict.html> <Enclosure 1> which concludes

*"All the auditors were guilty of failing to check financial statements and management assumptions with enough analysis and rigour, according to the AIU.*

*PwC – the world’s largest auditor – was censured for a catalogue of failings like its rivals, most notably for problems with its assessment of goodwill at two FTSE100 companies, weakness in the majority of its reviewed audits in relation to auditing of revenue, and issues with work led by an increasing number of audit directors, rather than partners. PwC, was also criticised for its handling of international bank subsidiaries in the UK particularly on provisions made against loan books."*

Richard Sexton, the newly promoted head of reputation at PwC, and who gave evidence to the Treasury Select Committee some three years ago on 7 December 2007 on Northern Rock

(<http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/7120412.htm>), responding to these AIU criticisms stated that PwC had now formulated a “detailed action plan”.

Just before this on 21 July 2011 the FRC also released their six page “True and Fair” Opinion and Paper <http://www.frc.org.uk/press/pub2605.html> to the auditors and public reinforcing its centrality.

3) the Supplementary written submission by the ICAEW Professional Conduct Director to Lord MacGregor’s House of Lords Committee in November 2010

**Further supplementary memorandum by Mr Veron Soare, Executive Director, Professional Standards, ICAEW (ADT 9)**

*..... I would like to comment on a number of the points that were made during the Committee hearing on Tuesday 9 November at which representatives of the supervisory community, including the Financial Reporting Council (FRC), gave evidence. As a Recognised Supervisory Body (RSB) for statutory audit under the Companies Act 2006, the ICAEW has a useful perspective to offer on the matters raised. ....*

*“With reference to the AADB, it is able to use any disciplinary sanction open to the ICAEW, including the power to impose unlimited fines and exclude from membership. This arrangement continues the powers enjoyed by the AADB’s predecessor body, the Joint Disciplinary Scheme (JDS). Like the JDS, the AADB independently investigates public interest cases against audit firms registered with the ICAEW and is designed*

*to play a key role in maintaining confidence in the UK audit profession. **However, despite accumulating a substantial caseload the AADB shows no evidence of an ability to meet the promises concerning speed and thoroughness of investigation made at its outset. Indeed, according to its website, since announcing its first investigation in 2005, the AADB has brought only two cases to a tribunal hearing. An independent review of the effectiveness of its work may now be timely.***

and

(4) in the Memorandum from BIS to the House of Lords Committee in its submissions in 2010 at paragraph 9 where BIS state “*The present crisis is not, of course, the first to result in challenges to the audit structure. It is notable that the reaction to this and previous crises or scandals has been to tighten the regulation of accounting and audit....Nevertheless, these steps have not prevented some parties criticising audit and the auditors for failing to stop the most recent crisis from occurring. Others feel that the crisis cannot be attributed to a failure in audit or auditors.*”

Shortly before the Summer recess I met a Mr Senior-Milne with his constituency MP, Sir Alan Beith. At the conclusion of the meeting Sir Alan indicated that he knew you very well and that he would raise some of the matters we discussed with you. Last week Sir Alan Beith MP and I received an email and attached letter <Enclosure 2> from Mr Senior-Milne which includes three pages which set out the AADB’s story on its role and actions in the Northern Rock and Lloyds TSB subjects in relation to their auditors PwC. I would specifically draw your attention to paragraphs 9 – 16 of this document. Specifically within this you will also read at paragraph 10

*“The AADB has not identified any information indicating that there may have been any misconduct within the scope of the Scheme on the part of the auditors of Lloyds TSB such that it would be appropriate to consider the application of paragraph 6 (8)/ 5 (8) of its Scheme.*

and then in the concluding sentence of paragraph 11

*regarding Northern Rock. “In April 2008 the AADB decided not to investigate the conduct of PwC in relation to Northern Rock. The AADB Board concluded that the first criterion for an investigation was met, as there was a very clear public interest in what happened in respect of Northern Rock, but that the second criterion was not met as there was no information available to the AADB Board to suggest that there may have been any act of misconduct by the auditors.*

and then in paragraph 12

*..... “However to date the AADB has not identified any information indicating that the Board should review its decision of April 2008 on investigation of PwC in relation to Northern Rock. Although criticism has been made publicly of Northern Rock’s auditors (**for example in the House of Lords Economic Affairs 2011 report “Auditors :market concentration and their role”** as quoted in the Claim Form) there has been no information available to the Board to suggest that there may have been any misconduct within the scope of the Scheme by the auditors of the company.”*

and finally in paragraph 16

*“The AADB considers that it has acted in accordance with its functions and the Rules of its Scheme in its consideration as to whether an investigation into PwC’s conduct in relation to Northern Rock and generally in its consideration as to whether to investigate the conduct of accountants or accountancy firms in relation to any banks.”*

There seems to me that there is a fundamental point of some significance here. Although the FRC's mission is as the United Kingdom's independent regulator responsible for promoting confidence in corporate reporting it does not seem to consider that a crucial element in that public interest is that it should investigate cases such as these against the standards and practices which it is espousing elsewhere. If there are no issues which arise after a proper investigation and published accordingly this will build public confidence and trust. If there were then these can be addressed in the appropriate manner, including lessons learnt for the future.

To state in these cases that the AADB must have “misconduct” information before any investigation misses the point that they, of their own volition, on behalf of the public and other stakeholders should investigate. In my view these actions within the FRC should be mandatory and enshrined as a statutory obligation on the FRC in their public interest cases. A properly constituted investigation by independent regulators, regardless of the outcome, will earn the trust so vital in our society now. I expect that the House of Lords Economic Affairs Committee members felt exactly the same when they believed they should ask these questions during their Auditor investigation in the last parliamentary session. Mr Senior Milne has all received responses through Freedom of Information Requests from the Treasury and BIS that no

political instructions or guidance was given to the FRC that those investigations should not be carried out in either case.

I am sure that the echoes of the phone hacking evidence in Parliament /media and stories of the actions of the Metropolitan Police amongst others should resonate with you on this point. You may also be aware of my involvement with Mr Tyrie MP and his TSC members in actively promoting the “independent verification” of the PwC / FSA work at RBS <Enclosure 3> and I hope and expect in due course Lloyds/HBOS.

I look forward to hearing from you shortly on when the publication of the Consultation on the proposed new accounting and audit regulatory structure, after almost two years of deliberations within the FRC Board, will be available from the FRC and/or BIS.

Also when does the BIS Secretary of State or FRC intend to publish the Final Paper on the Lessons Learnt in the Financial Crisis, discussed as recorded above at the FRC Board meetings, or indeed present it to this Parliament. It may of course be that it will be integral part of that Consultation in helping to naturally underpin the substance and evidence for those regulatory changes.

Also, if or when, there will be any independent review of the effectiveness of the AADB in carrying out its work since 2005 after the Mayflower PLC, Equitable Life – E&Y, Northern Rock , Lloyds/TSB “public interest” experiences etc. It is my provisional view from the evidence available to me that the role of the AADB could be amalgamated to save UK taxpayer cost and improve effectiveness with the FRC/Professional Oversight Board where it would have access to the Audit Inspection Unit skills and practical experience. It also seems to me that you should refer to paragraph 17 in the Enclosure 2 submission and consider why the Professional Oversight Board may only ask an accountancy body to take action in response to the POB’s findings in relation to a complaint but has no power to overturn the decisions of any accountancy body on individual complaints or to direct the accounting body on it’s handling of individual complaints. Perhaps this may form part of the proposals in the forthcoming Consultation?

Finally to contribute further evidence in to the public domain I will shortly submit a FOI request in order to ascertain how many investigations and subsequent disciplinary actions have been taken by the accounting regulators, such as the ICAEW, in each of the last three years against each of the BIG FOUR auditors – PwC , Deloitte, KPMG, and E&Y. Within this how many of these investigations were launched on their own volition in each of those three years since 2008.

I look forward to hearing from you.

Yours faithfully,

A handwritten signature in black ink that reads "Jim Shannon". The signature is written in a cursive style and is underlined with a single horizontal line.

Jim Shannon MP for Strangford

Copy     Sir Alan Beith MP  
           Mr Andrew Tyrie MP    and TSC members  
           Lord MacGregor    and HOL(Economic Affairs)members

Baroness Hogg    - FRC

Mr Paul George – FRC / POB / AIU

*Enclosure 1    Daily Telegraph - 26 July 2011*

*“Biggest audit firms hit by scathing regulator’s verdict”*

*Enclosure 2    Three pages extract from letter dated 8 August  
2011 from UK solicitors, Beachcroft LLP, representing the AADB  
in which they set out “The AADB’s monitoring of the role of the  
auditors in relation to the banking crisis” at Paragraphs 5 - 17.*

*Enclosure 3    TSC Chairman, Mr Tyrie MP, letter dated 14  
March 2011 to me in connection with FSA / PwC £7.7m+  
forensic investigation report on RBS.*

**Edward Davey MP**

Minister for Employment Relations,  
Consumer and Postal Affairs

Jim Shannon MP  
House of Commons  
London  
SW1A 0AA

Our ref:262509

22 October 2011

*Dear Jim,*

Thank you for your letter of 19 September about reforms to the structure of the Financial Reporting Council (FRC), and the publication of the Final Paper on the Lessons Learnt in the Financial Crisis.

You will be interested to hear that the Department and the FRC has just launched a joint consultation on proposals to the reform of the FRC. It invites comments on proposals around its structure and the focus of its activities. The document, "Proposals to Reform the Financial Reporting Council", can be found on the BIS website at [www.bis.gov.uk/consultations](http://www.bis.gov.uk/consultations) and responses are invited by 10 January 2012.

The Department is also currently consulting on "Audit Exemptions and Change of Accounting Framework. The consultation period, which began on 6 October, runs until 29 December 2011. This document may also be downloaded from our website.

The FRC has advised that their work on 'Lessons from the Credit Crisis' led to the publication of a consultation document on 'Effective Company Stewardship'. This was followed up by a next steps document published in September 2011. I have provided the links to both below.

<http://www.frc.org.uk/images/uploaded/documents/Effective%20Company%20Stewardship%20Final2.pdf>

<http://www.frc.org.uk/publications/pub2631.html>

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You also ask about a response to your letter dated 16 May 2011. Our records show that you wrote to the Secretary of State on the same date. A response to both letters was contained in the Secretary of State's reply of 8<sup>th</sup> July 2011.

yours,  


**EDWARD DAVEY**



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Minister      Mr Edward Davey MP  
Employment Relations, Consumer and Postal Affairs  
Department of Business, Innovation and Skills  
1 Victoria Street  
London  
SW1H 0HT

15 November 2011

Dear Mr Davey

Thankyou for your letter dated 22 October 2011  
(your ref 262509).

I have now read with interest the joint consultation on proposals for the reform of the FRC. The following items in my letter dated 19 September 2011 appear not to have been dealt with sufficiently and/ or appropriately in your letter and / or this “structural” reform of the FRC.

**Point 1 : My Letter dated 19 September 2011**

From page 6

QUOTE “Shortly before the Summer recess I met a Mr Senior-Milne with his constituency MP, Sir Alan Beith. At the conclusion of the meeting Sir Alan indicated that he knew you very well and that he would raise some of the matters we discussed with you. Last week Sir Alan Beith MP and I received an email and attached letter <Enclosure 2> from Mr Senior-Milne which includes three pages which set out the AADB’s story on its role and actions in the Northern Rock and Lloyds TSB subjects in relation to their auditors PwC. I would specifically draw your attention to paragraphs 9 – 16 of this document. Specifically within this you will also read at paragraph 10

*“The AADB has not identified any information indicating that there may have been any misconduct within the scope of the Scheme on the part of the auditors of Lloyds TSB such that it would be appropriate to consider the application of paragraph 6 (8)/5 (8) of its Scheme.*

and then in the concluding sentence of paragraph 11

regarding Northern Rock. *“In April 2008 the AADB decided not to investigate the conduct of PwC in relation to Northern Rock. The AADB Board concluded that the first criterion for an investigation was met, as there was a very clear public interest in what happened in respect of Northern Rock, but that the second criterion was not met as there was no information available to the AADB Board to suggest that there may have been any act of misconduct by the auditors.*

and then in paragraph 12

..... *“However to date the AADB has not identified any information indicating that the Board should review its decision of April 2008 on investigation of PwC in relation to Northern Rock. Although criticism has been made publicly of Northern Rock’s auditors (**for example in the House of Lords Economic Affairs 2011 report “Auditors :market concentration and their role”** as quoted in the Claim Form) there has been no information available to the Board to suggest that there may have been any misconduct within the scope of the Scheme by the auditors of the company.”*

and finally in paragraph 16

*“The AADB considers that it has acted in accordance with its functions and the Rules of its Scheme in its consideration as to whether an investigation into PwC’s conduct in relation to Northern Rock and generally in its consideration as to whether to investigate the conduct of accountants or accountancy firms in relation to any banks.”*

It seems to me that there is a fundamental point of some significance here. Although the FRC’s mission is as the United Kingdom's independent regulator responsible for promoting confidence in corporate reporting it does not seem to consider that a crucial element in that public interest is that it should investigate cases such as these against the standards and practices which it is espousing elsewhere. If there are no issues which arise after a proper investigation and published accordingly this will build public confidence and trust. If there were then these can be addressed in the appropriate manner, including lessons learnt for the future.

To state in these cases that the AADB must have “misconduct” information before any investigation misses the point that they, of their own volition, on behalf of the public and other stakeholders should investigate. In my view these actions within the FRC should be mandatory and enshrined as a statutory obligation on the FRC in their public interest cases. A properly constituted investigation by independent

regulators, regardless of the outcome, will earn the trust so vital in our society now. I expect that the House of Lords Economic Affairs Committee members felt exactly the same when they believed they should ask these questions during their Auditor investigation in the last parliamentary session. Mr Senior Milne has received responses through Freedom of Information Requests from the Treasury and BIS that no political instructions or guidance was given to the FRC that those investigations should not be carried out in either case.

I am sure that the echoes of the phone hacking evidence in Parliament / media and stories of the actions of the Metropolitan Police amongst others should resonate with you on this point. You may also be aware of my involvement with Mr Tyrie MP and his TSC members in actively promoting the “independent verification” of the PwC / FSA work at RBS <Enclosure 3> and I hope and expect in due course Lloyds/HBOS.

I look forward to hearing from you shortly on when the publication of the Consultation on the proposed new accounting and audit regulatory structure, after almost two years of deliberations within the FRC Board, will be available from the FRC and/or BIS.” UNQUOTE

Your consultation appears to rule out any matters other than specific audit matters. There appear to be no intent to consider at all any of the matters above or for example complaints about forensic accounting engagements, such as that for the HBOS whistleblower, Mr Paul Moore or my constituent , Mr Brian Little.

Is that to be future HMG policy? I would suggest that ministerial guidance in the public interest should be to the contrary. I will respond with others to the Consultation by January 2012 but would appreciate your perspective in advance.

**Point 2 : Page 9 continues**

QUOTE “Also when does the BIS Secretary of State or FRC intend to publish the Final Paper on the Lessons Learnt in the Financial Crisis, discussed as recorded above at the FRC Board meetings, or indeed present it to this Parliament. It may of course be that it will be integral part of that Consultation in helping to naturally underpin the substance and evidence for those regulatory changes.” UNQUOTE

Your letter of response referred me to the publication document on “Effective Company Stewardship”. I had expected your response to include the Lessons learnt for and

within the FRC and to have set out how the proposed regulatory structures and processes will now address that. The Effective Company Stewardship document does not address the internal FRC aspect and I cannot presently see the linkage of any Lessons Learned to the Joint Consultation BIS/FRC document.

Can you clarify and set this out please?

**Point 3 : Page 10**

QUOTE “Also, if or when, there will be any independent review of the effectiveness of the AADB in carrying out its work since 2005 after the Mayflower PLC, Equitable Life – E&Y, Northern Rock , Lloyds/TSB “public interest” experiences etc. It is my provisional view from the evidence available to me that the role of the AADB could be amalgamated to save UK taxpayer cost and improve effectiveness with the FRC/Professional Oversight Board where it would have access to the Audit Inspection Unit skills and practical experience. It also seems to me that you should refer to paragraph 17 in the Enclosure 2 submission and consider why the Professional Oversight Board may only ask an accountancy body to take action in response to the POB’s findings in relation to a complaint but has no power to overturn the decisions of any accountancy body on individual complaints or to direct the

accounting body on its handling of individual complaints. Perhaps this may form part of the proposals in the forthcoming Consultation?” UNQUOTE

I note that the joint consultation proposes the amalgamation I referred to above. I endorse that proposal. It does, however, seem to me that the BIS/FRC Consultation

(a) specifically intends that the FRC exclude all non-audit matters ... for example Northern Rock , HBOS etc

(b) has not addressed the criticism / observation of the effectiveness of the AADB (see ICAEW submission to the House of Lords Economic Affairs Committee). Perhaps you should commission an independent review in parallel with this Consultation to determine whether more changes should be made at the same time before these matters are put to Parliament.

(c) is not very clear on the regulatory powers and “remedies/ sanctions” which the FRC now requires to exercise consequences which it considers necessary in the profession and public interest. Today we know the POB is virtually “toothless” despite the findings in its Audit Inspection reports.

**Point 4 : Page 10 continues**

QUOTE “Finally to contribute further evidence in to the public domain I will shortly submit a FOI request in order to ascertain how many investigations and subsequent disciplinary actions have been taken by the accounting regulators, such as the ICAEW, in each of the last three years against each of the BIG FOUR auditors – PwC , Deloitte, KPMG, and E&Y. Within this how many of these investigations were launched on their own volition in each of those three years since 2008.” UNQUOTE

I did submit an FOIA request on 29 September 2011 to BIS. <Enclosure 1>. They did not have any of the information as part of their governance processes <Enclosure 2>. I then submitted the same request to the FRC on 19 October 2011 <Enclosure 3>. They did not have the information. <Enclosure 4>

I have now written on 15 November 2011 to the individual accounting institutions <Enclosure 5> and will keep you appraised of their responses.

I look forward to hearing from you.

Yours faithfully,

Jim Shannon

Jim Shannon MP for Strangford

Copy Sir Alan Beith MP

Mr Andrew Tyrie MP and TSC members

Lord MacGregor and HOL (Economic Affairs)members

Baroness Hogg - FRC

Mr Paul George – FRC / POB / AIU

Mr Paul Moore

Mr Graham Senior Milne

**Edward Davey MP**

Minister for Employment Relations,

Consumer and Postal Affairs

Jim Shannon MP  
Constituency Advice Centre  
34a Frances Street  
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BT23 7DN

Our ref: 271709

8 December 2011

*Dear Jim,*

Thank you for your letter of 15 November, about reforms to the structure of the FRC.

You raise a number of points about the current open consultation on the reform of the Financial Reporting Council (FRC), including the issue of the handling of complaints about forensic accounting engagements and seek my perspective in advance.

I understand that you wrote to the Secretary of State on 29 September seeking his views on handling your constituent's complaint about a forensic accounting issue. The Secretary of State noted in his reply that your constituent would need to raise the issue with the Canadian authorities because the firm to which the complaint relates is Canadian; and that the FRC has no locus in this matter as the firm is not under any investigation in the UK; and it would not be appropriate for us to intervene in the processes of another country.

As highlighted in the consultation document, the FRC is seeking to focus its resources and efforts in the areas of most risk, which it believes can be achieved by focusing on the work and conduct of accountants in relation to the capital markets, allowing other cases of potential misconduct to be dealt with by the relevant professional body; and that the proposed reform should not introduce any further regulatory processes which could significantly impact on business. The emphasis on risk and impact is, in part, a response to the issues arising from consideration of the financial crises. It is important that we receive views on the issues and options presented in the consultation; and equally, that we hear about other areas of interest that respondents believe should be addressed before any decisions are taken. Therefore, it would not be appropriate for me to express any views whilst this process is on-going.

You requested clarification on my referral to the document "Effective Company Stewardship" in response to your question in your letter dated 19 September 'Also, when does the Secretary of State or the FRC intend to publish the Final Paper on the Lessons Learnt in the Financial Crisis, discussed as recorded above at the FRC Board meetings, or indeed present it to this Parliament'. This work on lessons learnt was subsequently presented as the above named document. A further paper on next steps was published in September this year. Chapter 5 of the document titled 'Fostering Quality Improvements' notes 'To ensure that proposals within the document can be implemented effectively, FRC's powers need to be reviewed to reinforce its effectiveness and independence and to enable flexible, real-time intervention in the interests of investors and the effectiveness of capital markets'. Consequently, section 4 of the consultation document 'Independent supervisory and disciplinary arrangements' and Section 5 'Proportionate regulation' considers the case for more proportionate powers and the ability for FRC to demonstrate its independence.

You list a number of points that you feel the consultation does not specifically address. I welcome your views on those aspects that you feel should also be considered in this consultation. Unless you advise otherwise, I will treat your observations as a response to the consultation document so that your views are considered as part of the process of agreeing the way forward on the reform of the FRC.

Yours,  
Edward Davey

**EDWARD DAVEY**



**RECEIVED**

12/12/11



**Jim Shannon**

**Constituency Advice Centre**

**34a Frances Street**

**NEWTOWNARDS**

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**Tel: 02891 827990**

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Minister      Mr Edward Davey MP  
Employment Relations, Consumer and Postal Affairs  
Department of Business, Innovation and Skills  
1 Victoria Street  
London  
SW1H 0HT

21 December 2011

Dear Mr Davey

Thank you for your letter dated 8 December 2011 – ref 271709  
in response to my letter dated 15 November 2011.

Turning firstly to the comments you make regarding my constituents complaint. We had understood from the concluding paragraph in your letter dated 22 October 2011 that there was some coordination of correspondence for the SOS and your private offices. It appears in fact that there are two private offices and that you were unaware from Dr Cable's private office that we did follow his initial guidance from his letter dated 26 October 2011 on the relevant accounting referrals to the Canadian accounting regulators (CICA) ; as we specifically copied that email/CICA letter to his private office in my email dated 2 Dec. 2011 at 16.16 /subsequently and before your letter dated 8 December 2011.

Dr Cable MP (and perhaps AGO Mr Grieve MP) have still to finalise and advise in response to my latest letter dated 7 December 2011 how we will handle the criminal (Royal Canadian Mounted Police) and securities regulatory referrals (Ontario Securities Commission) in my constituents case .

As for the handling of the relevant parts of my constituents complaint for the UK based accounting regulatory authorities in the FRC and ICAEW my concerns about this overall investigatory process and governance increase every month. For a member of the public, without MP support, this type of "experience" to date is in my view unpardonable. I will form a more concrete view on Monday 16 January 2012 when I meet

the “subject matter experts” from the ICAEW considering our complaint and their processes. This will enable me to gather further real time evidence from a “real” experience.

I would add that I continue to be astonished as to why the FRC/AADB Chairman Mr Walker chose to ignore the BIS 2009 legislation referring these complaints from Tribunals to the FRC, those charged by Parliament with the role to investigate, where it is evident that the case could / would damage public confidence in the accounting profession in UK.

Turning now to the BIS/FRC consultation on the reform of the FRC etc. In the final paragraph of your letter dated 8 December you state

*“You list a number of points that you feel the consultation does not specifically address. I welcome your views on those aspects that you feel should also be considered in this consultation. Unless you advise otherwise, I will treat your observations as a response to the consultation document so that your views are considered as part of the process of agreeing the way forward on the reform of the FRC”.*

That is helpful and as a backup I will file some of our correspondence (my letters dated 19 September 2011, 15 November 2011 and this 21 December 2011 letter together

with your replies dated 22 October 2011 and 8 December 2012) with the FRC receipt point for the BIS/FRC consultation by 10 January 2012.

I have also been reading the recommendations from the FRC/Sharman Inquiry on Going Concern and Liquidity Risks – Lessons for Companies and Auditors - November 2011. In particular Recommendation 1 and the comments in paragraph 51 in which they note that *“The Panel has, however, noted the limited extent and nature of public reports into high impact cases of corporate collapse in the UK, in contrast to the position in certain other jurisdictions, notably in the US (the Valukas Report on Lehman Brothers) and in Ireland (the Nyberg Report). While research into the circumstances surrounding the government support provide to the Royal Bank of Scotland has been undertaken , the publication of any report into the findings has been delayed by the need for an independent review. Furthermore, the Panel notes that research into the underlying causes of corporate collapse is limited. Accordingly, the Panel recommends steps that might be taken to establish a more systematic approach to learning lessons when significant companies fail through its own inquiries (and then refers to this October 2011 Consultation document on Proposals to Reform the Financial Reporting Council in referring to “it has recently been proposed that the FRC should undertake supervisory*

inquiries at its own initiative”) *and working with other regulatory agencies.*

As you know I (and others) have raised as examples on auditor investigations in the public interest

- (a) Northern Rock
- (b) Lloyds/HBOS
- (c) the forensic report by KPMG in 2004 in its investigation of Paul Moore’s whistleblowing at HBOS  
and now
- (d) RBS – investigation of Deloitte

As I understand the FRC have always had the powers to investigate in the public interest IF THE FRC/AADB BOARD chose to do so ..... Amended Accountancy Scheme effective 8 December 2011 paragraph

“ **4(1)** A Member or Member Firm shall be liable to investigation under this Scheme only where, in the opinion of the Board:-

- (i) (a) the matter raises or appears to raise important issues affecting the public interest in the United Kingdom (“the first criterion”); and
- (b) **the matter needs to be investigated to determine whether there may have been an act of misconduct** (“the second criterion”); or

(ii) it appears that the Member or Member Firm has failed to comply with any of his or its obligations under paragraphs 12(1) or 12(2) below.”

this was point 1 in my prior letters. That FRC/AADB Board decided not to launch any investigation to do so.

Point 2 - Lessons learnt - I cannot see an effective response to this point. As we have seen in the recent FSA report on RBS there has been an attempt to set out the failings and lessons to be learned at the FSA and in the new Body.

What is the equivalent at the FRC? Perhaps one example could be that the FRC/AADB Board were NOT sufficiently minded in the public interest to even launch an investigation of the evidence in to the role of the auditors and whether Deloitte in fact met the espoused Code of Ethics and accounting standards and guidelines at the institutions mentioned above. But for Mr Tyrie MP and his TSC persistence there would not have been any “independent review” of Parts 1 & 2 of the FSA report and its publication earlier this month for RBS.

Where is the FRC equivalent for auditors Deloitte ...RBS ..... “wilful blindness” by the Board? Why are these matters only left to Parliament e.g. the HOL Economic Affairs Committee to ask about in November 2010. We know from answers to FOI

requests by Mr Graham Senior Milne earlier this year that there was no political / HMG ministerial requests by the Treasury or BIS to influence those independent / arms length Boards not to investigate.... “No light touch regulation” – damaging public confidence in the accounting profession.

Point 3 I agree with the emphasis on FRC rationalization but not with the limited regulatory reform as I set out in some examples at page 7 of my letter dated 15 November 2011. The professional conduct, in accordance with their Code of Ethics of individual members and members are matters which are important in investor **and public confidence** in the accounting “profession” and forensic investigations.

As Paul Moore, the HBOS whistleblower stated in his letter dated 30 January 2011 to me

**“It seems to me that, in any civilised and developed society, if we cannot be satisfied so that we are sure that we can trust and rely on the competence, integrity and independence of our professionals - people who are supposed to be the best educated, brightest and most honest people in society - we are in real trouble.”**

Point 4 : Regulatory and disciplinary Governance information

Further to this point in my letter dated 15 November 2011 I have received feedback from the ICAEW which indicates that they do not have the information and are not prepared to share it in the public interest as the FRC have not sought it and instead because Dr Cable MP and his ministerial colleagues such as yourself have never asked for it – nor is it a statutory obligation – it will not be provided publicly.

I have circulated Dr Cable MP and you on another email today at 14.24 which includes the ICAEW letter in response. I note that your response did not address the question I put to you in regard to commissioning an independent review in parallel with this Consultation to determine whether more changes to determine whether more changes should be made at the same time before these matters are put to Parliament.

You will recall that it was Lord MacGregor’s HOL Committee which received the ICAEW Mr Soare’s supplementary memorandum in November 2010 in which he included

**“Further supplementary memorandum by Mr Veron Soare, Executive Director, Professional Standards, ICAEW (ADT 9)**

*..... I would like to comment on a number of the points that were made during the Committee hearing on Tuesday 9*

*November at which representatives of the supervisory community, including the Financial Reporting Council (FRC), gave evidence. As a Recognised Supervisory Body (RSB) for statutory audit under the Companies Act 2006, the ICAEW has a useful perspective to offer on the matters raised. ....*

*“With reference to the AADB, it is able to use any disciplinary sanction open to the ICAEW, including the power to impose unlimited fines and exclude from membership. This arrangement continues the powers enjoyed by the AADB's predecessor body, the Joint Disciplinary Scheme (JDS). Like the JDS, the AADB independently investigates public interest cases against audit firms registered with the ICAEW and is designed to play a key role in maintaining confidence in the UK audit profession. **However, despite accumulating a substantial caseload the AADB shows no evidence of an ability to meet the promises concerning speed and thoroughness of investigation made at its outset. Indeed, according to its website, since announcing its first investigation in 2005, the AADB has brought only two cases to a tribunal hearing. An independent review of the effectiveness of its work may now be timely.**”*

I would hope that the FRC parallels with the FSA “experiences” should be apparent to us all. For my part I will also have some more practical experience with my constituent in mid

January 2012 to add to this evidence-led commentary on accounting regulation in the UK.

Finally my letter dated 23 November 2011 to you on two specific proposals for future Employment Tribunal Regulations (under locus of BIS) for whistleblowers remains outstanding.

I look forward to hearing from you.

Yours faithfully,

A handwritten signature in cursive script that reads "Jim Shannon". The signature is written in dark ink on a light-colored background.

Jim Shannon MP for Strangford

Copy – as circulation of my letter dated 15 November 2011

Baroness Hogg - Chair of the FRC

Dr Vince Cable MP – BIS Secretary of State

Mr Andrew Tyrie MP – Chairman of the TSC

Sir Alan Beith MP - Chairman of the Justice Select Committee

Lord MacGregor-Chair of the HOL Economic Affairs Committee

Mr Paul Moore

Mr Graham Senior Milne