

## Reviewing the Internal Governance Rules

A public consultation issued by the Legal Services Board (LSB)

Comments from ACCA  
February 2018  
Ref: TECH-CDR-1664

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 200,000 members and 486,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 101 offices and centres and more than 7,200 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting, and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

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# GENERAL COMMENTS

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ACCA welcomes the opportunity to comment on the LSB's review of the Internal Governance Rules (IGR) to explore whether changes are needed in order to enhance regulatory independence. However, we would discourage any amendments to the IGR that would make them more prescriptive.

We welcome the comment, in paragraph 3 of the consultation document, that the LSB wants to see '*a legal services market that is characterised by a regulatory framework that commands the trust and confidence of consumers ...*'. The LSB itself is central to that regulatory framework, and the IGR that it is required to maintain represent one of many elements within that framework.

## **Better regulation principles and upholding the regulatory objectives**

As ACCA stated in its response to the LSB's consultation on its regulatory performance assessment process,<sup>1</sup> '*The assessment of regulators' performance is core to the role of an oversight regulator and it is important that this process is transparent and remains robust*'. We are concerned that the LSB attributes too much importance to detailed rules, rather than performance based on sound principles, and that a significant resource is directed by the LSB into reviewing and amending rules when the principles of better regulation are clear, and set out in section 3(3) of the Legal Services Act 2007 (the Act).

The LSB and the approved regulators (ARs) are all required to promote the regulatory objectives set out in Part 1 of the Act. Therefore, if any amendment to the IGR is required it must be to support these principles, rather than threaten them by making the IGR more prescriptive.

In our opinion, reasonable opportunities to reduce the regulatory burden on ARs (and their members) must be identified and exploited. We believe that any '*inconsistent regulatory burden*' (referred to in paragraph 33 of the consultation) should *not* be addressed through increased regulation for its own sake.<sup>2</sup> Instead, the reason for the inconsistency should be examined. In respect of the different requirements of ARs and applicable approved regulators (AARs) in the IGR, any inconsistency should be addressed by clearly articulating the principles. This will simplify and 'future proof' the IGR. It then becomes the responsibility of the LSB to assess how each AR implements the requirements in accordance with the better regulation principles.

As we stated in our response to the LSB consultation on regulatory performance assessment: '*... the need for consistent standards should not be confused with a need for uniform standards. We therefore welcome the adoption of a risk-based and targeted approach to legal services regulation which takes account of the regulatory objectives, the better regulation principles, best regulatory practice and the diversity of approved regulators. ... Assessment of regulatory performance which is centred on outcomes that identify areas for regulatory attention will help to drive continuous improvement in the effectiveness and efficiency of regulatory arrangements and this safeguards the public interest.*'

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<sup>1</sup> Regulatory performance assessment: Consultation on the proposed revised regulatory performance assessment process

<sup>2</sup> Page 4 of the consultation refers to 'evidence of dissatisfaction with the exclusion of certain ARs from some of the more detailed obligations set out in the Schedule to the IGR'. But the basis for that dissatisfaction has not been explained in the document.

With regard to internal governance, the principle set out in section 30 of the Act is that the exercise of an AR's regulatory functions is not prejudiced by its representative functions. Unfortunately, in other respects, the Act focuses on the creation of rules, rather than the required outcomes. We acknowledge that the LSB is hampered by the prescriptive drafting within the Act. Therefore, we recommend that the IGR make clear the requirements that are simply prescribed by the Act, in order to isolate those inflexible requirements from the essential principles. A focus on the principles would then allow the IGR to focus on outcomes, rather than prescriptive inputs.

### **The principle of regulatory independence**

The principle of regulatory independence is achievable in different ways. However, we believe that complete independence of a body's representative and regulatory functions is unworkable, and it is important that this truth is acknowledged in order to focus on safeguarding the principle.

Many (if not all) ARs are required to act in the public interest and, in some cases, this is made clear in their constitutional documents, such as a Royal Charter. Public trust, which includes being seen to uphold the public interest, does not conflict with a professional body's role of serving its members' interests. In supporting its members, safeguarding the interests of stakeholders (and the wider public) is fundamental to the brand and reputation of a professional body.

Ironically perhaps, wider separation of representative and regulatory functions increases the risk of conflict between the two functions of the organisation, and may give rise to a culture of mistrust, impeded communication and reduced transparency. On the other hand, a professional body that sees the interests of its members (collectively) and the public as aligned also sees the benefits of independent decision-making within its regulatory processes, and so builds independence into those processes, along with transparency. For example, some ARs have introduced their own independent regulatory boards to exercise regulatory oversight in the public interest. In this way, the AR remains (and is seen to be) an effective regulator.

ACCA was formed, in 1904, with a strong regulatory purpose – in order to set its members apart from other accountants. ACCA has extensive experience as a regulator, and its regulatory governance structure now includes the incorporation of robust public interest oversight arrangements for its regulatory activities. Through our Regulatory Board, we assure stakeholders that ACCA's regulatory arrangements are operated impartially, with integrity, and in the public interest.

## **AREAS FOR SPECIFIC COMMENT**

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In this section, we set out our responses to the specific questions set out on pages 30 to 31 of the consultation document.

### **Question 1: We welcome evidence on (i) the general nature, frequency and impact of disagreements on regulatory independence matters, and (ii) how the IGR are used and their effectiveness in moderating such disagreements.**

ACCA is not an AAR, and will encounter little difficulty in complying with the IGR. As a professional body of accountants – providing regulatory and representative functions – ACCA is organised in such a way that its regulatory functions can operate independently of its other functions. This is helped by a clear understanding that robust regulatory arrangements are

fundamental to the ACCA brand, and always have been, and so there is no conflict between these functions.

Nevertheless, we recognise the importance of being *seen* to take regulatory decisions in the public interest, and so we welcome effective independent oversight and transparency concerning ACCA's regulatory arrangements. Internally, independent oversight is provided by ACCA's Regulatory Board (and three sub-boards), details of which may be found on ACCA's website (<http://www.accaglobal.com/uk/en/member/standards/regulatory-board.html>).

**Question 2: What are the benefits and costs to stakeholders of operating under the existing IGR framework?**

The IGR are required by the Act, and it is important that they are drafted in such a way that they support independent decision-making in matters concerning regulation. LSB oversight should monitor effectiveness in this respect, and be transparent in its operations and findings. The IGR must provide a framework to enable this, but must also provide the flexibility to allow the most effective arrangements for a diverse range of ARs.

The existing IGR framework includes a Schedule that is too prescriptive. Any future changes should be evaluated and justified on the basis that they make the requirements clearer, and reduce the potential for conflicts between AARs and their regulatory bodies. If this could be achieved, it might remove any need for dual self-certification, which itself relies on appropriate independence, and would not appear to have been effective in the past.

**Question 3: Do you agree with option 1: no change to the IGR? Why or why not?**

We believe that changes are required only to the Schedule to the IGR, and so we prefer option 2a to option 1. In our opinion, an outcomes-focused approach to LSB oversight requires a move away from prescriptive rules (which cannot legislate for every eventuality) towards a principles-based framework, which allows achievements and shortcomings to be identified and addressed appropriately. Such a framework would also encourage an environment of learning through continuous assessment, rather than focusing solely on addressing non-compliance.

**Question 4: What information do AARs need to receive from their regulatory body, and why? To what extent can these needs be met through transparency (and vice versa), thereby removing the need for further engagement?**

This question demonstrates how the Schedule to the IGR may give rise to confusion, because it refers to an AAR and its regulatory body as two separate entities. This undermines the definition of an AAR, which includes the criterion that it is responsible for both regulatory and representative functions. A clear separation of the two functions within the same entity allows the LSB to focus its communications on that part of the entity that is responsible for the regulation of legal activities. The only information that the so-called regulatory body would need to provide to other parts of the AAR would relate to the robustness and effectiveness of the regulatory function. (Please refer to our introductory comments above concerning the relationship between upholding the public interest and serving members' interests.)

**Question 5: Do you want more intervention by the LSB in disputes between AARs and regulatory bodies? If so, what form should this intervention take?**

We do not consider it appropriate for ACCA to respond to this question in detail, as ACCA is not an AAR. However, we believe that such intervention should be used as a last resort. As a guiding principle, we believe that disputes that are resolved by agreement produce better outcomes, as they encourage more effective ongoing relationships.

**Question 6: Do you agree with option 2a: making incremental changes to the IGR? Why or why not?**

Yes, we support option 2a. We would encourage a simplification of the Schedule to the IGR. Beyond that, we would not support change without any clear benefit. The driver for change should be to enhance focus on the principles.

**Question 7: What incremental changes should the LSB prioritise, and why?**

A simplification of the Schedule to the IGR would make clear that there are a number of ways in which appropriate separation of functions may be achieved (without generating conflicts). As well as being more effective, this would also serve to address the challenge of an 'inconsistent regulatory burden'.

**Question 8: What do you anticipate the impact of your proposed change(s) would be, and why?**

Please refer to our response to Question 7 above.

**Question 9: Do you agree with option 2b: making more extensive changes to the IGR? Why or why not?**

No, we do not support option 2b.

**Question 10: What new obligations would you recommend the LSB prioritises, and why?**

Please refer to our response to Question 9. We would not support the imposition of new obligations.

**Question 11: What do you anticipate the impact of those proposed new obligations would be, and why?**

Please refer to our responses to Questions 9 and 10 above.

**Question 12: Do you agree that the definition of AAR should be revised? Why or why not? If so, how do you think the definition should be revised, and why?**

Please refer to our response to Question 13 below.

**Question 13: What do you anticipate the impact of revising the AAR definition would be, and why?**

If the AAR definition were to be revised, it should focus more on the second element of the definition – that its functions are in respect of persons whose primary reason to be regulated by the AR is their qualification to practise a reserved legal activity regulated by the AR. Under the current IGR, ACCA meets the definition of AR and not that of AAR. The distinction between ARs and AARs reflects the fundamental differences between accountancy professional bodies and legal professional bodies, and acknowledges that different measures are required in each case in order to keep the bodies' regulatory arrangements at arm's length to their representative functions (and be seen to do so).

ACCA's regulatory functions in relation to legal activities (specifically probate) are in respect of accountants and *not* in respect of persons whose primary reason to be regulated by ACCA are those persons' qualifications to practise a reserved legal activity. Therefore, ACCA is an AR and is bound to comply with rules 6 and 7 of the current IGR, but it is not appropriate for ACCA to comply with the Schedule to the IGR. The Schedule is applicable to AARs only and requires the AAR to delegate responsibility for performing all regulatory functions to a so-called regulatory body without any representative functions.

The original reason for the distinction between ARs and AARs was proportionality, primarily to address the problem of the definition of 'lay' (which is different for an accountancy body) because the Act provided limited flexibility in this respect. In our opinion, the desire to change the AAR definition appears to be driven by the current AARs. We believe that reasonable opportunities to reduce the regulatory burden on ARs (and their members) must be identified and exploited. However, any '*inconsistent regulatory burden*' (referred to in paragraph 33 of the consultation) should not be addressed through increased regulation for its own sake. Instead, the reason for the inconsistency should be examined.

In respect of the different requirements of ARs and AARs in the IGR, any inconsistency should be addressed by clearly articulating the principles. This will simplify and 'future proof' the IGR. It then becomes the responsibility of the LSB to assess how each AR implements the requirements in accordance with the better regulation principles. Indeed, at the LSB's IGR Review Stakeholder Event on 29 November 2017 there was recognition that 'consistent standards' do not necessarily mean the same structures and processes.

**Question 14: Do you agree that the definition of regulatory independence should be revised? Why or why not? If so, how do you think the definition should be revised, and why?**

The principle of regulatory independence is achievable in different ways. However, complete independence of a body's representative and regulatory functions is unworkable, and it is important that this truth is acknowledged in order to focus on safeguarding the principle. Indeed, the Act refers to regulatory independence '*so far as reasonably practicable*'. We do not agree that the definition of regulatory independence should be revised. In our opinion, the focus should be on regulatory outcomes that are in the public interest, rather than identifying the source of any possible 'undue influence', or a requirement for separate 'regulatory bodies'.

**Question 15: Do you agree with option 2c: a new 'gateways' approach to the IGR? Why, or why not?**

No, we do not support option 2c.

**Question 16: What gateways (i.e. permissible channels for information and assurance to flow between regulatory bodies and their AARs in the normal course of events) do you think would be needed, and why?**

Please refer to our response to Question 15 above.

**Question 17: Do you think independent standards or benchmarks could be used to indicate when AARs are able to seek additional assurance? If so, what are these, and why?**

Please refer to our response to Question 15 above. The introduction of ‘independent standards’ or benchmarks would introduce complexity, and represent a move further away from the fundamental principle of regulatory independence set out in section 30 of the Act.

**Question 18: What action do you think an AAR should be entitled to take when seeking additional assurance in the circumstances described above, and why?**

Please refer to our responses to Questions 15 and 17 above.

**Question 19: What do you anticipate the impact of the ‘gateways’ approach would be, and why?**

Please refer to our response to Question 17 above.

**Question 20: What, if any, alternative approach to reviewing the IGR do you suggest the LSB should consider, and why? What impact do you think that would have, and why?**

We would support option 2a. Specifically, we would encourage a simplification of the Schedule to the IGR, if this could have a substantive impact on clarity of the IGR and compliance with the fundamental principle of regulatory independence. We would not support any alternative approaches to reviewing the IGR, as we feel these would be counter-productive to achieving this objective.

**Question 21: Do you agree with reintroduction of DSC to assure compliance with the IGR? If so, what form should this take and why? What do you anticipate the impact of DSC would be, and why?**

Any reversion back to seeking DSC from AARs might suggest that the LSB is transferring responsibility for oversight to the AARs, which we believe is inappropriate and ineffective. DSC suggests a focus on gaining assurance, rather than on the required outcome – that of effective and independent regulation in the public interest.

The consultation suggests that assurance concerning compliance with the IGR may be achieved through ‘incorporating IGR compliance into our regulatory performance assessments’.<sup>3</sup> We would support the use of the LSB’s regulatory performance assessment process. However, we believe that focus on IGR compliance could present

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<sup>3</sup> Page 4 of the consultation

a risk that the ultimate objective would be overlooked – that of robust, independent regulation.

**Question 22: Do you agree with IGR compliance becoming part of regulatory performance assessments? If so, why? What do you anticipate would be the impact of IGR compliance becoming part of regulatory performance assessments, and why?**

We broadly support the inclusion of IGR compliance as part of the regulatory performance assessment process, subject to our concerns expressed in response to Question 21 above. As stated in our response to Question 3, we believe the LSB should move away from a prescriptive approach to IGR compliance, and towards a principles-focused framework. Assessment of regulatory performance which is centred on outcomes will help to drive continuous improvement in the effectiveness and efficiency of regulatory arrangements.

**Question 23: Do you agree with the existing option for proactive reporting of non-compliance? If so, why? What do you anticipate the impact of this would be, and why?**

It is incumbent upon any regulatory body (AR or AAR) to communicate any relevant failings to its lead regulator. This should not need to be stated in regulations; rather it is to be expected where regulators and lead regulators exercise due regard for the public interest, and where appropriate channels of communication exist.

**Question 24: Do you agree with third party assurance? If so, why? What do you anticipate the impact of this would be, and why?**

As ACCA stated in its response to the LSB consultation on its regulatory performance assessment process, we would caution against the use of third-party feedback which is neither meaningful nor relevant. Third-party feedback should be supported by evidence, and balanced with other evidence collected about the regulators' performance.

**Question 25: What, if any, alternative approaches to assuring compliance with the IGR do you suggest the LSB should consider, and why? What do you anticipate the impact of these would be, and why?**

We have already expressed our belief that seeking assurance concerning compliance with the IGR risks losing sight of the ultimate objective of robust independent regulation. We have no further comments in this respect.

## CONCLUSION

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Overall, it is not entirely clear, from the consultation document, what advantage might be achieved by amending the IGR. The definition of an AAR includes the characteristic that it is responsible for the discharge of both regulatory *and* representative functions.<sup>4</sup> Therefore, reference to an AAR's 'regulatory body' in several places throughout the consultation appears contrary to the definition. The Schedule to the IGR explains what is meant by 'regulatory body',

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<sup>4</sup> Regulatory performance assessment: Consultation on the proposed revised regulatory performance assessment process, page 7

but this would suggest that improvements should be made to the drafting of the Schedule. However, care must be taken not to undermine the principles in doing so. We are concerned that a focus on trying to achieve greater separation of an AAR and its (so-called) regulatory body would lead to a more complex Schedule without achieving more objective decision-making in the public interest.

Independence is an important factor in achieving effective regulation. It gives confidence to consumers, providers of legal services, and society as a whole, and so helps to safeguard the public interest. However, placing too much focus on the rules that require independence ignores the actual goal – that of objective decision-making in regulation. Independence does not necessarily imply objectivity, and objectivity does not necessarily require absolute independence. We believe that complete independence of a regulatory body's representative and regulatory functions is unworkable. Furthermore, regulation must be adequately funded, and any attempts to suggest that regulation of a profession can be independently funded are usually illusory.

The IGR must be based on upholding important principles. Otherwise, detailed and prescriptive rules obscure the underlying objectives of those rules. The oversight of the LSB should focus on the required outcomes (rather than on inputs) by having IGR that can be applied to every possible situation.