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Accounting firms continue to face regulatory scrutiny in 2020

Is your firm adequately informed and prepared?

Accounting firms continued to grow and diversify their practices throughout 2019, with many transforming into multi-disciplinary professional services and product firms.

At the same time, risks associated with conduct and compliance were put under the spotlight. Due to several high-profile company failures and poor results from regulatory reviews, many accounting firms and individuals were recipients of fines and sanctions from a number of different regulators.

Pressures and trends in 2020

This trend is expected to gain momentum throughout 2020. Company failures and regulatory reviews have gained substantial media attention and have received global press coverage. An 'expectation gap' remains between the actual mandate of statutory audits and the general public's desire to assign blame for company failures, asking "where were the auditors?"

Increasingly, regulators are under pressure to respond strongly to these events, even when the auditors are confronted with sophisticated frauds and deceived by their clients. In other cases, independence issues have been cited as contributing factors and regulators continue to investigate these situations.

Driven by a desire to demonstrate greater oversight and motivated by their duty to protect investors and the public, regulators will continue to scrutinize firms. Some jurisdictions are more active than others. Certain regulators and governing bodies across the globe are seeking more punitive or radical reprimands, such as the comprehensive review of the structure and competition within the audit market in the UK, but the trend is clear. Regulators are examining:

- The nature of the audit
- The independence of the firms
- The nature of the market for audits
- Issues of culture and behavior within the firms
- Trends within the profession

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Regulators are taking action

Traditionally, the primary action taken by regulators has been fines, but regulators are now increasingly prohibiting firms from working in certain sectors or for certain types of companies for set periods of time. These sanctions can be against the entire firm or against specific partners or managers within the firm.

To date, the fines against the firms have been relatively modest in comparison to, for example, those levied against financial institutions. Some critics argue that the impact of these fines has also been modest. It remains to be seen whether fines will increase, but greatly increased regulatory fines would clearly be a concern for the partners of professional service firms as often, for public policy reasons, insurance will not be allowed to respond, leaving partners to bear the cost.

For accounting firms, perhaps the most impactful penalties are sanctions. An inability to operate in key sectors for set amounts of time and having important partners side-lined, can cause interruptions in business processes that are difficult to quantify. Impacts may include the negative implications for the reputation of the firm, the potential loss of clients who may look to disassociate themselves from the sanctioned firm, the impaired ability to retain the right staff and to hire new staff, and disengagement of the current staff. These factors may have severe consequences on the revenue streams of the firms. Such impacts may also be felt from the sanctioning of another member firm within an international network, particularly one of significance globally or within a particular region.

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Moving forward

If a regulatory fine or sanction does occur, robust response strategies are crucial.

Fines and penalties are traditionally uninsurable by law, although under certain circumstances, allowed in some jurisdictions. **Insurance coverage** is, however, available for some of the impact of a regulatory event.

There are insurance policies that cover some aspects of business interruption. Similarly, reputational insurance products are available and evolving in their scope of coverage. Articulating and recovering from an interruption in a firm’s business or reputational damage is challenging and complex, both from the perspective of calculating the loss and connecting the loss to the triggering event. However, insurance policies like those covering reputational risk can also cover the more immediate costs attributed to damage control, such as working with public relations’ agencies and the response cost to the firm to mitigate and to limit the reputational impact of a regulatory fine or sanction.

Securing the right insurance coverage can be challenging, but by working with **a specialist broker**, firms can assess their risks and access appropriate and competitive coverage in varied markets.

If you would like to discuss any of the issues raised in this article, please contact **John Dorf** or **Rona E. Davis**.