BUSINESSEUROPE

European Commission
DG Internal Market and Services, Unit F4 - Auditing / Liability
SPA 2 (JII), 02/085
B-1049 Brussels, Belgium
E-mail: markt-f4@ec.europa.eu

23 March 2007

Dear Sir or Madam,

Commission Staff Working Paper: Consultation on Auditor's Liability and its impact on the European Capital Markets

BUSINESSEUROPE welcomes the discussion on auditor's liability. As the paper states: business needs access to high quality audits at a reasonable cost.

The working paper further states that the international audit market is comprised of a very limited number of players, namely the "Big 4". BUSINESSEUROPE would like to see more players in this market. We agree with the Commission that steps need to be taken to spur other audit companies to enter the international audit market.

However, BUSINESSEUROPE does not think that an EU-wide cap on auditor's liability is the right way to progress. The working paper seems to be based on the presumption that a cap on the auditor's liability is the right solution, but the paper fails to give persuasive supporting evidence to this presumtion. A "catastrophic claim" is not the only threat or obstacle – being connected to "catastrophic reputation" as conceived by the general public is much more so - and BUSINESSEUROPE questions whether a liability cap would have saved Arthur Andersen.

BUSINESSEUROPE is of the general opinion that the EU should not establish pan-European rules on limitation of auditor's financial liability, especially not regarding statutory audits. Because of great differences in the national law systems, this should be a matter for the individual member states to decide.

These national differences should be addressed prior to any discussion on a cap on auditor's financial liability. The Annexes to the working paper briefly touch on some of the national differences, but the paper does not take these differences into sufficient consideration. Also, the relations between the parties in contract (the inter-partes relationship) as well as the adverse nature of the assignments are not fully addressed.

Further, we are aware that audit firms cannot obtain general insurance coverage. This is caused by the fact that the audit firms are involved in a large number of claims which means that they are paying large amounts in compensation. Insurance companies will on that account be paying substantial compensation which they somehow have to cover. The paper on auditors' liability mentions a loss ratio of up to 266 % of average premiums in the period 1981 to 1992.

Even with a limitation of auditor's financial liability the fundamental problem will not be solved. The large number of claims suggests that the problem lies elsewhere. BUSINESSEUROPE would like to propose that the claims are categorised in order to identify the root cause of the claims. If it is negligence, BUSINESSEUROPE does not see a need for changes. If it is uncertainty as to the service provided by the auditor, i.e. the level of assurance provided by an unqualified auditor's opinion, this should be clarified.

It should be noted that a network can get into trouble in other areas than the statutory audit. There have been recent concerns that one of the Big 4 would have faced serious problems if US tax authorities (IRS) had taken legal actions regarding certain tax consultancy services being provided by one of the Big 4. Such a case would not be solved by limitation of auditor's liability and these types of problems should therefore also be considered.

BUSINESSEUROPE would thus like to see a thorough discussion on the national differences combined with an analysis of the nature of the claims. The analysis should not be limited to the statutary audit. Based on this BUSINESSEUROPE would be prepared to discuss a harmonisation of the rules governing the auditor's liability, but as stated above BUSINESSEUROPE cannot support this on the basis of the arguments presented..

Public insurance coverage could be a short term solution if the Commission and the Member States is concerned about the present situation. This could be linked to the work performed by public audit oversight bodies. This way auditors would see a clear benefit from increased public control, and the third party's rightful expectation for coverage of its claims based on tort would be intact. This would also ensure the time needed to the above analysis and discussion.

If you have any questions on the above, please do not hesitate to contact me.

Yours sincerely,

Jérôme P. Chauvin
Director, Legal Affairs Department

Annex

Question 1: Do you agree with the analysis of the option of fixing a single monetary cap at EU-level?
We do not support a single monetary cap at EU level (see below).

Question 2: Would a cap based on the size of the listed company, as measured by its market capitalisation be appropriate?
See below.

Question 3: Would a cap based on the audit fees charged to the company be appropriate?
See below.

Question 4: Do you agree with the analysis of the option of introduction of the principle of proportionate liability? What are your views on the two ways in which proportionate liability might be introduced?

In the case that a Pan-European limitation on auditor's financial liability is chosen (which we do not support), consideration should be given to setting the maximum at a level where the audit firms still face a genuine liability. An outright insufficient audit (negligence) should under no circumstances be included in the limitation of auditor's liability.

The four models all have weaknesses. It is important that there as a minimum is a connection between the loss suffered by third party (tort) caused by auditor and the compensation that the third party is entitled to receive. A model based on the size of the firm or the size of the auditor's fee does not make this connection.

There should also be a connection between the character of the error committed by the responsible party and a possible limitation of responsibility, e.g. a higher liability for losses suffered due to the auditors own culpability.

A pan-European maximum will not work as there is a great difference on the relative impact across Europe caused by a fixed maximum. The financial strength in local audit firms are very different e.g. a London office will in most cases have a financial power that is significantly bigger than a Copenhagen office. A fixed European maximum will therefore primarily favour the largest offices at the expense of both third parties as well as smaller offices and small and mid-tier networks.

The solution proposed in question 4 whereby the member states allow proportionate solutions to be negotiated between the company and its auditor seems the only reasonable solution if the financial liability needs to be capped. Transparency would need to be ensured by both an approval by the general meeting as well as disclosing the liability cap in the auditor's opinion. We agree that in this event national courts could still override the agreement.

* * *