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Dear Sir or Madam

Commission Staff Working Paper: Consultation on Auditors' Liability and its Impact on the European Capital Markets

The Committee of European Banking Supervisors welcomes the opportunity to comment on the Commission Staff Working Paper: Consultation on Auditors' Liability and its Impact on the European Capital Markets (Working Paper).

Through their opinions on annual accounts and annual reports, external auditors constitute an integral part of the public oversight model and contribute to the financial stability of the market. As banking supervisors we therefore have an interest in ensuring that audits are conducted to the highest quality.

Before launching the Working Paper on auditor liability, we believe that two issues should have been addressed by the European Commission. First it would have been more appropriate to consult on whether the relevant stakeholders within the EU saw any need to consider an EU-wide approach to auditor liability. This would have identified whether such a Working Paper was necessary in the first place. Second, as we note in the appendix, the different legal systems in the EU may be a hindrance to harmonisation of auditor liability within the EU.

In the appendix we provide further elements contributing to the complexity of establishing an EU-wide approach to auditors' liability. Against this complexity and given the limited approach of addressing audit quality through reform to auditors liability, we do not concur with the direction of the working paper. Given our position, our comments are not addressed to any specific question raised therein.

Our comments were coordinated by our Expert Group on Financial Information (EGFI), and especially by its Subgroup on Auditing, which is under the direction of Pat Sucher from the FSA, UK.

If you have any questions regarding our comments, please feel free to contact the chairman of EGFI, Arnoud Vossen (+31.20.524.3903) or Miss Pat Sucher (+44.20.7066.5644).

Yours sincerely

A handwritten signature in black ink, appearing to be 'D. Nouy', is located below the text 'Yours sincerely'.

Danièle Nouy
Chair

Appendix

Comments on the Commission Staff Working Paper: Consultation on Auditors' Liability and its Impact on the European Capital Markets (Working Paper)

We do not believe an EU-wide policy initiative to harmonise national approaches to auditor liability is currently necessary. Our rationale is as follows:

Audit quality – other aspects

We do not see why harmonising auditor liability has been identified as the key issue with regard to investors having confidence in audits, audit quality and financial reporting. We believe there are many other aspects, other than auditor liability, that are covered in the 8th Directive and are likely to have more impact on audit quality and therefore investor confidence. As an example, under the 8th Directive, auditor oversight boards and their inspection processes for ensuring quality assurance of audits have been or are being established within the EU. Through their audit inspection work, the oversight boards will be in position to improve the quality of audit, and therefore decrease the likelihood that an audit firm will undertake negligent audit work which might, in turn, lead to a claim for damages.

Audit market concentration and auditor liability

We are not convinced by the arguments raised in the Working Paper that capping auditor liability across the EU will materially lessen the likelihood of the exit of a Big Four audit firm from the audit market or increase the choice of audit firm for larger public interest entities. We note in particular that, as far as we know, no audit firm has so far failed within the EU due to a catastrophic liability claim against it. Furthermore, we are not aware of compelling evidence that limiting auditor liability will help mid-tier audit firms become significant players in the international audit market. There is evidence, in some EU countries, that the barriers to entry for other audit firms seeking to enter the 'Big Four' audit market are more substantive in such areas as perceived reputation of the audit firm, third party perceptions and the necessary investment needed to enter such a market¹.

We believe that more research is needed to confirm the arguments in the Working paper especially to establish the likelihood of one of the Big Four audit firms exiting the market due to audit failure. Moreover resources should be invested in other means that help improving audit quality as well as developing appropriate contingency plans, if necessary.

Complexity of establishing an EU-wide approach to auditor liability

Given the European legal principles of adopting EU laws that are appropriate in the context of the principles of subsidiarity and proportionality, we are unclear why the EU Commission would choose to try and establish an EU approach to auditor liability. As laid out in the appendix to the Working Paper there are currently a variety of approaches to auditor liability within the EU.

Given this variety, to adopt a converged approach to auditor liability for all EU member states would be very difficult given:

- The different approaches to who is liable (the audit firm network, the audit firm or the auditor);
- The impact of any limiting of liability for auditors on other professions within member states;
- The complexity of setting the most appropriate limitation on liability;
- The different approaches to who can claim damages (audited company; third parties);
- The variety of approaches to how proof of damages has to be provided; and
- The linkages with local civil and criminal law.

¹ See, 'Competition and Choice in the UK audit market' Oxera, 2006, for analysis and references