

Auditors' Liability

Current Status:

Article 31 of the 17 May 2006 Statutory Audit Directive requires that the European Commission studies "*the impact of current national liability rules of the carrying out of statutory audits on European capital markets and on the insurance conditions for statutory auditors and audit firms, including an objective analysis of the limitations of financial liability. The Commission shall, where appropriate, carry out a public consultation. In the light of that report, the Commission shall, if it considers it appropriate, submit recommendations to the Member States.*" In September 2006, the results of an independent study by the consultancy firm London Economics were published by the Commission and a public consultation followed up in January 2007.

Currently, auditors' liability is limited in: Austria, Belgium, Germany, Greece, Slovenia and the United Kingdom; furthermore, reforming auditors' liability is underway or is being considered in: Bulgaria, Czech Republic, Estonia, Spain and Sweden – a total of 11 Member States.

Despite this growing number of Member States and the support for reform expressed in the public consultation of the Commission, some still oppose much needed action at EU level (less than 30% of the 85 respondents to the public consultation) and FEE is concerned that the factual evidence and findings of the independent study by London Economics (LE) are being ignored.

- Meaningfully, almost all stakeholders from Member States where there is already a limitation on auditors' liability – i.e. the Member States where there is concrete experience and objective knowledge of how a limitation operates in practice for the benefit of the public interest – are in favour of EU reform.
- Although the LE study concluded that there was no evidence of lower audit quality in Member States with limitations in place, some continue to uphold that unlimited auditors' liability is a driver for audit quality while it mainly propels defensive auditing. The theoretical analysis shows that unlimited liability may result in a situation where the economic costs of unlimited liability exceed the benefits.
- One of the objectives of reform should be to contribute to enhance the insurability of auditors' liability; otherwise unlimited liability is an illusory condition as the resources to meet the liability are not unlimited. In effect, the LE study found that the level of commercial insurance was insufficient.
- Middle-tier firms face a number of barriers to entry into the market, including unlimited liability which, in addition, makes it more difficult to retain professional staff.

FEE Positions:

- FEE agrees with the principle that statutory auditors must be held appropriately responsible for their statutory audit but to no greater extent than is reasonable. Auditors do not seek a favourable regime but to address the problem of so-called catastrophic claims.
- FEE thinks that the issue of auditors' liability should be looked at from a market standpoint, not solely from the viewpoint of individual auditors; it is the structural (macro-economic) dimension of the issue that matters from an EU perspective and must be addressed at EU level as an Internal Market issue. The focus must be on the sound functioning of capital markets, the interests of all market players and the long term sustainability of the whole statutory audit profession, as one of the essential safeguards of the public interest.

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- FEE believes that action to limit auditors' liability will also contribute to making progress regarding choice on the audit market; it is therefore of importance for mid-tier firms and for the public interest.
- FEE considers that all Member States should provide a limitation of auditors' liability in a way that accommodates their legal systems. However, the most suitable solution may differ from one Member State to another and should respect the solutions already in place; in such cases, there is no need to change the existing arrangements.

Next Steps:

- On 18 June 2007, the Commission issued a report on the public consultation showing growing support for reform. An impact assessment and a policy decision should follow up.
- Since limiting auditors' liability is a necessity for the proper and sustainable functioning of the European Internal Market for capital, it is important to act now and not wait for a crisis to arise. This becomes more important given the uptake of the debate in the US and the need to enhance choice on the audit market.
- FEE urges the EC to issue a Recommendation and all Member States to limit auditors' liability in a way that accommodates their different legal systems. FEE looks forward to an EU Recommendation in this respect in Autumn 2007.

References:

- **Final Report to EC-DG Internal Market and Services by London Economics** in association with Professor Ralf Ewert, Goethe University, Frankfurt am Main, Germany, "Study on the Economic Impact of Auditors' Liability Regimes" (MARKT/2005/24/F) of September 2006.
- **Statutory Audit Directive, 17 May 2006**
http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_157/l_15720060609en00870107.pdf
- **Forum on Auditors' Liability**
http://ec.europa.eu/internal_market/auditing/liability/index_en.htm#forum
- **Consultation on possible reform of liability rules in the EU**
http://ec.europa.eu/internal_market/auditing/liability/index_en.htm#consultation
- **FEE Press Release on Debating auditors' liability in the EU**
http://www.fee.be/publications/default.asp?library_ref=4&content_ref=632

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About FEE:

The Fédération des Experts Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe. It groups together 44 professional bodies from 32 countries. Between them, these bodies have a combined membership of 500,000 individuals.