European Commission
Attn. DG Internal Market and Services
Unit F4 - Auditing / Liability
SPA 2 (JII), 02/085
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Date	Re	Our ref	Attachment	Direct dial nr
March 15, 2007	Consultation Report on auditors' liability	Liability/RS	-	**T** +31 20 3010301 **F** +31 20 3010302

Dear Sir, Madam,

We appreciate the opportunity to comment on the Commission Staff Working Paper: Consulting on auditors' liability and its impact on the European Capital Markets. Based upon the review of the consultation document our opinion is the following:

Royal NIVRA is of the opinion that option 3 is the most preferable. A cap related to the audit fee charged to the company will prevent catastrophic claims, will ensure competition and provides an adequate balance between audit quality and liability risk. We recommend to investigate option 3 in more detail.

POSSIBLE OPTIONS FOR LIABILITY REFORM IN THE EU

The London Economics Study assessed the various possible approaches to liability reform on the basis of 4 criteria: (1) impact on the risk that one or several of the big-4 will disappear in case of catastrophic claims; (2) impact on insurability of statutory audit liability risk; (3) impact on competition and entry into the market of mid-tier firms; (4) impact on audit quality. It concluded that the key issue in terms of reduced risk for audit firms and increased competition by the audit firm is not so much the precise form of the limitation as the level of liability that firms face in a regime in which auditors' liability is limited. The study considered the pros and cons of 4 options.

Option 1: One single monetary cap at EU level

Examples of absolute caps can be found in Germany, Austria and Belgium (see Annex I). The monetary caps in Austria, Belgium and Germany were developed purely for domestic cases, mainly to improve domestic insurance cover and they differ from each other considerably. Extending such a model to the entire European Union would have the following implications:

A European-wide cap would imply a maximum harmonisation of liability regimes for the European Union.

Finding the appropriate level would be very challenging. If such a cap were set too high, mid-tier audit firms would be further disadvantaged. If, on the other hand, the cap were set too low, this might have a negative impact on the quality for the audit of major listed companies.

The differences in companies' sizes (and the associated audit risks) and in the economies of Member States are significant. A single European-wide cap might amount to a "one size fits all" solution for 27 Member States, which would fail to take account of the diversity of circumstances in different Member States in terms of audits and company size.

Insurers clearly signalled to the Commission that an EU-wide cap would not necessarily improve the insurance situation for audit firms at international level.

Question 1: Do you agree with the analysis of the option of fixing a single monetary cap at EU level?

Answer 1: We agree with the analysis. However although the option is easy to apply it fails to take into account the diversity of circumstances. It would be difficult to determine the level of the limit as the size of companies differ and middle tier firms should not be disadvantaged. Therefore we reject this option and we do not recommend examining alternatives within this option.

Option 2: Cap depending on the company's size

Another option could be a variable cap on auditors' liability depending on the company size. A variable cap would be more transparent and easier to apply as compared with proportionate liability. This option, based on an audit risk approach, recognises that the magnitude of risk of statutory audit liability may vary with the size of the listed company whose accounts are audited (e.g. measured by its market capitalisation). Statutory audit liability risk also appears to be higher in certain industries and differs for small listed companies compared to "blue chip" companies. The determination of the applicable amount thus remains relatively transparent for investors and public at large as information about the size of the company is publicly available.

To be efficient, the variable ceiling should be fixed at a level that reduces risk of collapse due to catastrophic claims. On the other hand, it should not lead to the creation of barriers to entry to the market for smaller audit firms.

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

Answer 2: The size of the listed company may give an indication of the business risk and the audit risk. There may also be a relation between the size of the listed company and the audit fee. However the audit risk depends on many other factors such as the quality of the internal control and reporting systems, the control attitude of management and the complexity of the business. Problems are the determination of market capitalisation when unlisted, the risk profile of the company and the way the variable cap can be determined.

Therefore we reject this option and we do not recommend examining alternatives within this option.

Option 3: Cap depending on the audit fees charged to the company

A cap might be based on a multiple of the audit fees charged by the auditor to its client. This option might steer the conduct of auditors towards audit quality adapted to audit risks and deliver a balance between audit efforts and liability risks. It would also give protection against catastrophic claims that would be more effective compared to the other options. A variable cap based on auditor's fees should be transparent in the future since disclosure of audit fees is required under Article 50 of the Statutory Audit Directive.

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

Answer 3: There is a relation between the size of the company and the audit fee. More risks will lead to more audit work and a higher fee. There will also be a relation between liability risk and audit risk because the higher the audit risk, the higher the liability risk will be. This cap would prevent situations where the amount of the claim is not in proportion with the audit fee. The audit fee may be a more realistic base for calculating a cap than a company's size. Audit fees are required to be disclosed in accordance with the Statutory Audit Directive.
The calculation of a fee-based cap could equally reflect an additional weighting for listed companies.
There needs to be discussion with third countries (notably the USA) to explore ways in which an EU cap can equally apply in those non-EU jurisdictions. EU/US discussions will also be required as non-statutory EU caps may impair the independence of EU auditors with clients that have securities listed in the US.

Option 4: Proportionate liability

The principle of proportionate liability means that each party is liable only for the portion of loss that corresponds to the party's degree of responsibility.
As described in section 2.4 above, investors may perceive "joint and several liability" regimes as a kind of loss insurance. Under proportionate liability investors could only expect to recover from the auditor the portion of loss that can be attributed to the auditor's actions (or inaction). The fundamental guiding principle would be that the auditor should be liable for damages in accordance with his degree of responsibility for the damage suffered.
Proportionate liability might help preventing catastrophic claims against audit firms in the European Union.
Proportionate liability could be implemented in two manners:

(1) Member States could change their laws to allow Courts to award damages only for the portion of loss corresponding to auditor's degree of fault, or

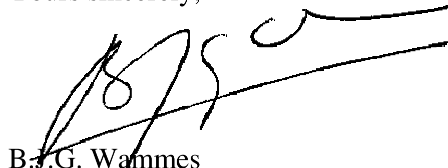
(2) Member States could allow proportionate solutions between the company and its auditors to be negotiated and enshrined in contractual arrangements. Shareholders of the audited listed company would have to approve such arrangements when appointing the auditor or when approving audited financial statements in a general meeting. Such an approved limitation could however be overridden by a

national court if it were to find that what has been agreed is not in accordance with what should be considered as fair and reasonable.

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?

Answer 4: We agree with the analysis outlined. The proportionate liability system is the system as recognised in the Netherlands (version 1). It is a complicated but fair system. Complicated because it is very difficult to establish the portion of loss that can be attributed to the auditors actions. Fair because the auditor is only liable for damages in accordance with his degree of responsibility for the damage suffered.
For the internal market it is of importance that different rules regarding liability should raise no barriers between the member states and that unreasonable claims should not jeopardise the function of audits. Liability should be limited where the consequences for the society and capital markets of inadequate functioning of auditors is of greater importance than unlimited liability. The exact determination of the proportion has to be mandated or determined by an independent third party for this proposal to work. Contractual limitations will not protect an audit firm against third party claims (e.g. banks) or most shareholder claims.

Yours sincerely,



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