

Limits and Restructuring of Auditor Civil Liability: An Analysis based on Fault-Liability Proportionality in China

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ABSTRACT

To address the problems of excessive liability exposure and overbroad attribution of liability faced by accounting firms under China's registration-based IPO regime, this article proposes a doctrinal reconstruction of the current civil liability framework for securities audits, grounded in the principle of proportionality between fault and liability. The audit expectation gap and the regulatory–judicial disconnect have distorted the obligation of “reasonable assurance” into a de facto “guarantee of results,” thereby giving rise to a solvency-driven deep pocket effect. This article argues for moving beyond narrow legislative debates and establishing a tiered liability system. First, it proposes clarifying the degrees of fault through an expert assistant mechanism. Second, it calls for a differentiated allocation of liability forms: full joint and several liability for intentional misconduct, proportionate joint and several liability for gross negligence, and supplementary liability for ordinary negligence. Concurrently, a judicial discretion model incorporating factors such as causative potency and the balance of risk and reward should be established to achieve a dynamic equilibrium between investor protection and the development of the auditing industry.

KEYWORDS

Misrepresentation; Accounting Firms; Civil Liability; Proportionality between Fault and Liability.

1. INTRODUCTION

With the comprehensive deepening of reforms in China's capital market, the framework of a registration-based IPO system centered on information disclosure has been formally established. Amid this historic transformation, accounting firms-serving as the most critical professional assurance institutions in the capital market-have undergone a profound shift in their institutional role, evolving from mere attesters of financial statements to true ‘gatekeepers’ of market integrity. Regulatory authorities have expressly emphasized strengthening intermediary accountability and implementing a ‘zero-tolerance’ regulatory approach. These measures aim to curb the persistent problem of financial fraud by listed companies and to safeguard investors’ legitimate rights and interests through enhanced external oversight mechanisms. Against this backdrop, the audit quality of accounting firms directly affects the efficiency of resource allocation and systemic financial stability in the capital market.

However, alongside the intensification of regulatory responsibilities, the civil liability environment facing accounting firms has undergone profound changes.

The newly revised Securities Law of the People's Republic of China (hereinafter referred to as the "PRC Securities Law") has significantly raised the cost of violations for securities service providers, establishing a stricter principle of presumption of fault and a regime of joint and several liability. In judicial practice, driven by the imperative to swiftly compensate investor losses and settle mass disputes, Chinese courts have shown a clear tendency to expand the scope and severity of auditor

civil liability. While this high-pressure stance has temporarily enhanced deterrence against fraud, it has also triggered widespread professional anxiety within the auditing industry. How to strike a balance between reinforcing gatekeeper duties and maintaining the healthy development of the auditing industry [1]-thereby preventing functional alienation of audit institutions or market shrinkage due to excessive accountability-has become an urgent issue that both securities law scholarship and judicial practitioners must confront.

In recent years, a series of landmark judgments-most notably the Kangmei Pharmaceutical and Wuyang Bond cases-have brought the crisis of auditor civil liability to the forefront of public and academic debate. A salient feature of these cases is the severe disproportion between the compensation liability borne by audit institutions and the consideration they receive for their audit services. While accounting firms typically charge audit fees ranging from hundreds of thousands to several million RMB, they face potential joint and several liability amounting to hundreds of millions or even billions. This severe misalignment between risk and reward has fundamentally undermined the auditing industry's risk-control framework, rendering professional liability insurance and risk funds largely inadequate in the face of massive compensation claims.

A deeper crisis lies in the distortion of judicial reasoning. Since the primary perpetrators of misrepresentation-issuers and their controlling shareholders-often fall into financial distress and lack solvency once fraud is exposed, accounting firms, possessing relatively stable assets and professional liability insurance, have become the ideal targets for compensation. Driven by a utilitarian orientation aimed at maintaining social stability and compensating losses, judicial authorities tend to expand the application of joint and several liability. This practice reallocates ultimate liability away from issuers-who are the primary wrongdoers-and onto audit institutions, effectively transforming accounting firms into the deep pockets and ultimate guarantors of the capital market [2].

While this model of liability allocation may facilitate investor compensation in individual cases, it produces significant adverse effects in the long run. On the one hand, it gives rise to adverse selection: leading accounting firms with strong risk-control capabilities may withdraw from high-risk segments of the audit market in order to avoid unlimited joint and several liability, resulting in a classic "bad money drives out good" dynamic. On the other hand, it incentivizes excessive defensive auditing. By excessively expanding audit procedures and accumulating redundant evidence to construct a liability shield, this approach not only substantially increases institutional transaction costs but also undermines the economic essence of auditing as a reasonable assurance service [3].

In light of the foregoing, and given that substantive statutory amendments are unlikely in the short term, there is an urgent need to achieve a more precise alignment between fault and liability through doctrinal and interpretive refinements at the level of legal application [4]. Against this backdrop, this article takes this challenge as its point of departure and develops a tiered liability framework that combines refined standards of fault determination with differentiated forms of liability allocation, with the aim of re-anchoring the civil liability regime in the private law principle of proportionality between fault and liability.

2. A JURISPRUDENTIAL REASSESSMENT OF SECURITIES AUDIT LIABILITY

The generalization and overload of auditor liability in China's current judicial practice are not merely problems of legal technique or application. Rather, they are deeply rooted in the misinterpretation of the legal nature of audit obligations, the institutional entrenchment of the audit expectation gap, and underlying value conflicts among different branches of law. This section undertakes a systematic examination of the institutional logic of securities audit liability from both theoretical and doctrinal perspectives.

2.1. Analyzing the Nature of Audit Obligations: Obligation of Means versus Obligation of Result

Accurately characterizing the legal nature of audit obligations is the logical starting point for delineating the scope of auditors' civil liability. In civil law theory, obligations are traditionally divided into obligations of means and obligations of result, depending on the content and standard of the debtor's performance. An obligation of means requires the debtor to exercise reasonable professional care, without making the attainment of a specific outcome the criterion for establishing breach of contract or tort liability. By contrast, an obligation of result obliges the debtor to achieve a predetermined outcome, and failure to do so constitutes a breach.

Drawing on the civil-law dichotomy developed in Japanese legal scholarship, civil obligations are traditionally divided into obligations of means and obligations of result [5]. From the perspective of auditing theory and institutional design, the audit obligation of Certified Public Accountants (CPAs) should be properly characterized as an obligation of means. Under the Chinese Standards on Auditing (CSAs), the objective of an audit is to obtain reasonable assurance that the financial statements as a whole are free from material misstatement. Such reasonable assurance represents a high, but not absolute, level of assurance. Because modern auditing is premised on sampling techniques, a risk-oriented approach, and reliance on the auditee's internal controls-and is further constrained by the inherent limitations of audit methods and the concealed nature of fraud-even full compliance with professional standards cannot guarantee the detection of all financial misstatements.

However, in judicial practice, audit obligations are frequently distorted into obligations of result. Courts often depart from the procedural standards prescribed by auditing standards and instead adopt a result-oriented imputation logic: where a listed company is found to have committed misrepresentation and the audit firm has issued an unqualified opinion, auditors are presumed to have failed to exercise due professional care. This *ex post*, result-based reasoning effectively transforms the obligation of reasonable assurance into a *de facto* guarantee of financial statement accuracy, conflates audit risk with audit failure, and ultimately contradicts the jurisprudential essence of an obligation of means.

2.2. The Institutional Entrenchment of the Audit Expectation Gap

The concept of the audit expectation gap captures the objective divergence between public perceptions of the auditor's role and the actual capabilities of the auditing profession [6]. The literature generally distinguishes two dimensions of this gap: the performance gap, which arises when audit practice falls short of existing professional standards, and the reasonableness gap, which reflects expectations that exceed what auditors can reasonably achieve under prevailing standards and technical constraints.

In the securities market, investors-motivated by the desire to protect their own interests-often expect CPAs to function as "financial police" or "fraud detection experts," capable of uncovering all instances of corporate misconduct through the audit process. Although such expectations may appear intuitively legitimate, they substantially depart from the professional role of auditing as a third-party assurance service.

The more serious problem, however, is that judicial practice in China has increasingly institutionalized this unreasonable expectation gap. In numerous securities misrepresentation cases, courts, when assessing auditors' duty of care, frequently override professional standards and instead apply the cognitive standard of ordinary investors. While this approach formally responds to public demands for heightened intermediary accountability, it effectively employs legal coercion to impose on accounting firms an unlimited liability that they are structurally incapable of bearing. When liability is constructed on such a flawed cognitive foundation, it not only fails to deter financial fraud but also drives the auditing profession into a "defensive auditing trap" marked by a misalignment of

rights, responsibilities, and interests. In order to meet the judiciary's excessive expectations, audit firms tend to expand formalistic audit procedures, thereby generating a socially inefficient use of resources.

2.3. The Discord between Special Provisions of the Securities Law and General Principles of Tort Liability

At the level of normative application, the attribution of auditors' civil liability is confronted with a structural tension between the special liability rules of the PRC Securities Law and the general principles of tort law embodied in the PRC Civil Code.

Article 163 of the PRC Securities Law adopts an imputation framework based on a presumption of fault and joint and several liability. The legislative purpose of this design is to ease investors' evidentiary burden through a reversal of the burden of proof and to strengthen victim compensation by means of joint and several liability. This approach reflects the Securities Law's regulatory orientation as a special commercial statute that prioritizes market efficiency and investor protection. Yet, when applied to auditors, this regime sits uneasily with the Civil Code's foundational principles governing joint tortfeasorship and the allocation of liability.

Under Articles 1168 and 1172 of the PRC Civil Code, joint and several liability is generally predicated either on the existence of common intent or common negligence—that is, a meeting of minds—or, in the absence of such concerted intent, on the condition that each actor's conduct is independently sufficient to cause the entirety of the harm. In securities misrepresentation cases, however, issuers typically constitute the primary perpetrators of fraud and act with clear intentionality, whereas the fault of accounting firms more commonly takes the form of negligence in failing to detect the misconduct during the audit process. Treating these fundamentally different forms of conduct as a unified basis for full joint and several liability—by holding a merely negligent audit institution fully liable for an issuer's intentional fraud—not only lacks the requisite foundation of concerted action demanded by the doctrine of joint torts, but also runs counter to the principle of corrective justice in tort law. Corrective justice requires that liability be proportionate to fault and that the scope of compensation correspond to the actor's causal contribution to the harm.

This normative conflict gives rise to a judicial antinomy: strict adherence to the PRC Securities Law risks imposing disproportionate liability on audit institutions, whereas a return to the general principles of the Civil Code may be criticized as weakening investor protection. The challenge of reconciling this tension between special and general law at the interpretive level therefore constitutes a central normative problem that any reconstruction of auditors' civil liability must confront.

3. ALIENATION AND CRITIQUE OF JUDICIAL ADJUDICATION LOGIC: AN ANALYSIS BASED ON LANDMARK CASES

The normative ruptures and cognitive misalignments identified at the theoretical level are translated, in judicial practice, into an alienation of adjudicative logic. In recent years, a series of landmark decisions—most notably the Kangmei Pharmaceutical financial fraud case—have exposed persistent pathologies in courts' determination of auditors' civil liability, including the ex post inference of fault from outcomes, the overgeneralization of causation, and the instrumental use of joint and several liability. This section undertakes a close examination of these representative cases in order to assess the legitimacy and rationality of the prevailing imputation logic as it operates in practice.

3.1. Misconceptions in Fault Determination Driven by Retrospective Inference

In securities misrepresentation tort litigation, the determination of auditors' fault should be grounded in a conduct-based standard, which requires assessing whether the audit procedures performed by the

accounting firm complied with applicable professional standards. A review of the Kangmei Pharmaceutical case and comparable decisions, however, reveals that courts have frequently succumbed to hindsight bias and engaged in retrospective inference when assessing auditors' conduct.

Adjudicative reasoning shaped by hindsight bias tends to infer auditors' fault retrospectively from the magnitude of the resulting harm. In the Kangmei Pharmaceutical case, the listed company engaged in systematic financial fraud involving approximately RMB 30 billion by forging bank deposit certificates and fabricating business documentation. Faced with the sheer scale of the fraud, the court-while formally identifying certain procedural deficiencies, such as the auditor's failure to maintain effective control over bank confirmations-ultimately grounded its reasoning in an implicit assumption that the size of the loss itself evidenced auditor misconduct. The underlying logic suggests that the very fact that fraud of such magnitude went undetected was treated as sufficient proof of serious professional dereliction.

This mode of adjudication overlooks the inherently probabilistic nature of audit techniques and the practical challenges of fraud detection. In cases of sophisticated collusion-particularly where auditees conspire with third parties such as banks to provide falsified evidence-even auditors who fully comply with professional standards may be unable to uncover material misstatements. When courts divorce their assessment from the professional environment and technical conditions existing at the time of the audit, and instead evaluate auditors' duties of care solely on the basis of fraud uncovered *ex post*, they effectively negate the independent value of professional judgment. Such reasoning transforms an obligation of means into a *de facto* guarantee of results and compels accounting firms to bear legal responsibility for the inherent limitations of audit procedures.

3.2. Generalization of Discretion regarding Causative Potency and the Conflation of Primary and Secondary Liabilities

Fundamental principles of tort law require that the allocation of liability correspond to both the actor's degree of fault and the causal contribution of the conduct to the resulting harm. In securities misrepresentation cases, issuers' affirmative acts of fraud constitute the primary and proximate cause of investors' losses. By contrast, any audit failure on the part of accounting firms generally takes the form of passive negligence-namely, a failure to detect existing risks rather than to create them. As a result, the respective conduct of issuers and auditors differs fundamentally in terms of causal contribution.

The determination of loss causation serves as the last line of defense in balancing the divergent interests of securities market participants [7]. In current judicial practice, the determination of causation displays a pronounced tendency toward overgeneralization. In many cases imposing joint and several liability, courts rely on an expansive conception of joint tortfeasorship and fail to draw a meaningful distinction between issuers' affirmative acts of fraud and auditors' passive negligence. The Wuyang Bond case provides a salient illustration. In that case, although the audit firm's fault consisted primarily of inadequate verification procedures for accounts receivable-conduct that falls squarely within the domain of ordinary negligence-the court nevertheless imposed joint and several liability for the entirety of the debt, reasoning that the audit report had contributed to inducing market reliance.

By elevating a secondary causal factor to the level of total liability, this mode of judicial discretion collapses the hierarchical distinctions that structure legal evaluation-between commission and omission, as well as between intent and negligence. It disregards the inherently multi-causal nature of risk transmission in the securities market, indiscriminately attributing losses arising from a constellation of factors-including corporate governance failure, internal control breakdowns, and macroeconomic market risks-to the auditing process alone. Such reasoning not only violates the corrective justice requirement that liability be proportionate to fault, but also weakens legal deterrence against the primary wrongdoer by obscuring the boundaries of responsibility [8].

3.3. The Instrumentalization of Joint and Several Liability and the Deep Pocket Effect

Under the existing framework of securities civil litigation, joint and several liability was originally designed to strengthen remedies for injured investors. In judicial practice involving accounting firms, however, this liability regime has increasingly been instrumentalized as a mechanism for loss compensation, departing from its original normative function.

The deep pocket effect provides a central explanation for this judicial pattern [9]. Securities misrepresentation cases commonly arise when issuers are already in financial distress, leaving issuers and their controlling shareholders—the primary wrongdoers—with depleted assets and little capacity to satisfy judgments. Accounting firms, by contrast, typically maintain more stable cash flows and carry substantial professional liability insurance, rendering them comparatively solvent [10]. In a legal environment that prioritizes victim compensation, courts are therefore incentivized to extend joint and several liability so as to designate solvent audit institutions as substitute sources of recovery.

When judicial decision-making is oriented toward solvency rather than fault, the application of joint and several liability becomes ethically disproportionate. Even where an audit institution is culpable only for ordinary negligence or minor procedural deficiencies, the insolvency of the issuer frequently suffices to trigger full joint and several liability. Although such outcomes may satisfy the immediate social objective of investor compensation, they produce significant institutional distortions: through judicial coercion, losses that should properly be borne by market risk-takers and primary fraudsters are transferred to audit institutions that merely perform intermediary functions. This dynamic not only exceeds the risk-bearing capacity of accounting firms but also destabilizes the normative equilibrium of the securities market by undermining the alignment of rights, responsibilities, and interests among market participants.

4. HIERARCHICAL CONSTRUCTION OF FAULT DETERMINATION STANDARDS

The point of departure for addressing the problem of auditor liability overload lies in the professionalization and objectification of fault determination standards. Given the high degree of technical complexity inherent in auditing, courts must abandon hindsight-based, result-oriented reasoning and instead anchor fault assessment in compliance with professional auditing standards. Within the existing framework of the Securities Law, this section proposes a hierarchical model of fault determination that differentiates among intent, gross negligence, and ordinary negligence, and further argues for the use of expert assistants to mitigate informational asymmetries and achieve substantive justice in fault attribution.

4.1. Strict Definition of Intent: Substantial Examination of Subjective Malice

In the context of securities misrepresentation, intent refers to the subjective mental state in which an accounting firm, despite having actual knowledge of material misstatements in the issuer's financial statements, nevertheless issues an audit report containing false statements, misleading disclosures, or material omissions. Because intentional misconduct not only undermines the foundation of audit independence but also constitutes a direct betrayal of investor reliance, it warrants the most severe form of legal condemnation.

In judicial practice, the boundary between intent and negligence must be strictly maintained to prevent the improper elevation of gross negligence into intentional misconduct. The attribution of intent must be supported by a robust chain of evidence, and should rest on the satisfaction of the following core elements. First, collusive conduct. This requires evidence demonstrating that the auditor engaged in deliberate collusion with the issuer's management, including assisting in or participating in fraudulent

practices such as the fabrication of accounting records or the construction of fictitious transaction schemes. Second, knowledge coupled with acquiescence. This element is satisfied where audit working papers or internal communications show that the auditor had identified direct evidence of fraud but, in order to preserve client relationships or obtain improper benefits, deliberately concealed such information and issued an unqualified opinion without undertaking further verification procedures. Only where these conditions are met should an accounting firm be deemed to possess subjective malice and be subjected to the most stringent form of civil liability.

4.2. Objectification of Gross Negligence: Fundamental Deviation from Core Audit Procedures

Situated between intent and ordinary negligence, gross negligence represents the most contested form of fault in judicial practice. Although existing judicial interpretations define it as a “serious breach of the duty of care,” this formulation remains overly abstract and affords excessive room for judicial discretion. To constrain such arbitrariness, a more objectified determination standard anchored in core audit procedures must be established.

Gross negligence should therefore be delimited as a fundamental deviation by the accounting firm from the core requirements of professional auditing standards. In this sense, it does not encompass all audit deficiencies, but is confined to failures that strike at the heart of the audit’s assurance function. More specifically, the determination of gross negligence should focus on two objective dimensions. First, the absence of core audit procedures. This arises where, without justifiable cause, the auditor fails to perform key procedures directly related to the reliability of financial statements—such as external confirmation of accounts receivable, physical observation of inventory, or verification of bank deposits—and does not implement effective alternative procedures. Such a breakdown of basic audit functions evidences a disregard for the minimum standards of professional practice. Second, reckless disregard for indicators of fraud. Where clear red flags emerge during the audit—such as abnormal large-scale fund transfers or profit margins that deviate markedly from industry norms—yet the auditor fails to maintain professional skepticism, neglects to perform necessary additional verification procedures, and uncritically accepts management’s explanations, gross negligence may be established.

By anchoring gross negligence in these two objective criteria—core audit procedures and fraud red flags—courts can avoid the tendency to infer gross negligence solely from the eventual failure to uncover fraud, thereby preserving the distinction between conduct-based fault assessment and outcome-driven hindsight reasoning.

4.3. The Independent Scope of Ordinary Negligence: Reasonable Tolerance for Professional Judgment

In existing judicial precedents, ordinary negligence is frequently marginalized or absorbed into the application of joint and several liability. The construction of a tiered liability framework therefore hinges on recognizing ordinary negligence as an independent legal category and establishing a mechanism of reasonable tolerance for professional audit judgment.

Ordinary negligence refers to situations in which the auditor maintains the requisite level of professional skepticism and performs the basic audit procedures, yet exhibits technical imperfections or judgmental deviations in matters such as the selection of audit strategy, the determination of sampling scope, the execution of non-core procedures, or the evaluation of audit evidence. Such deficiencies do not reflect indifference to professional duties, but rather arise from the inherent limitations of audit technology and the constraints imposed by the cost-benefit principle. From a doctrinal perspective, ordinary negligence should be established only where two conditions are jointly satisfied: first, the procedural violation is minor in nature and confined to non-core audit procedures; and second, the auditor’s conduct bears only a low degree of causal connection to the resulting

damage. In such cases, the occurrence of misrepresentation should be primarily attributed to the issuer's intentional fraud or fabrication by external third parties, with the auditor's negligence merely marginally enlarging the scope of the loss.

Illustrative examples include situations in which the auditor conducts audit sampling in compliance with professional standards but, due to the inherent randomness of sample selection, fails to capture fraudulent transactions, or where audit working papers are imperfectly documented without affecting the substantive accuracy of the audit conclusion. Although such conduct falls short of ideal professional practice, it does not constitute a serious deviation from the behavioral paradigm of a rational and competent CPA. In legal evaluation, it must be acknowledged that auditing, as a professional assurance service, necessarily entails a permissible margin of error. Classifying such technical imperfections as ordinary negligence and sharply distinguishing them from gross negligence is therefore a necessary institutional arrangement for preserving the normal functioning and sustainable development of the auditing profession.

4.4. Procedural Safeguards through the Expert Assistant Mechanism

The effective implementation of tiered fault determination standards depends on the availability of corresponding procedural safeguards. The assessment of audit fault inevitably involves complex judgments regarding accounting standards and audit procedures, which lie beyond the professional competence of judges relying solely on ordinary life experience. To avoid the structural dilemma of lay adjudicators evaluating professional conduct, the expert assistant mechanism should be substantively integrated into the adjudication of securities misrepresentation cases [11].

In practice, when adjudicating cases involving the civil liability of accounting firms, courts should activate procedures for the determination of specialized issues or require expert witnesses to testify in court. Senior Certified Public Accountants or accounting scholars with substantial professional experience should be engaged to provide independent opinions on core questions, including whether the audit procedures complied with professional standards, whether the auditor maintained appropriate professional skepticism, and whether the failure to detect misstatements resulted from audit failure or from unavoidable audit risk.

Expert opinions should be subject to adversarial examination during trial and treated as key evidence for determining the nature of the auditor's fault. By anchoring fault attribution in expert standards, courts can shift their analysis from subjective judicial inference to industry-recognized professional benchmarks, thereby ensuring that the classification of intent, gross negligence, and ordinary negligence rests on a sufficiently credible technical foundation [12]. This procedural design not only enhances the rationality and technical accuracy of judicial decision-making, but also represents a necessary pathway for realizing the principle of proportionality between fault and liability at the level of procedural justice.

5. REFINED ALLOCATION OF LIABILITY FORMS

The hierarchical construction of fault determination provides the logical foundation for a differentiated allocation of liability. To correct the substantive inequity generated by the deep pocket effect in current judicial practice, it is necessary to strike an institutional balance between effective investor compensation and the continued viability of the auditing profession. This section therefore rejects the prevailing binary model of liability allocation and proposes a refined, tripartite structure of liability based on the accounting firm's degree of fault and its causal contribution to the misrepresentation. Specifically, this framework comprises full joint and several liability, proportionate joint and several liability, and supplementary liability, each corresponding to a distinct level of blameworthiness and causal contribution.

5.1. Intentional Misconduct: Unwavering Adherence to Full Joint and Several Liability

For intentional fraud committed by accounting firms, the application of full joint and several liability is firmly grounded in jurisprudential principles and possesses necessary policy legitimacy. According to Article 1168 of the PRC Civil Code, where two or more persons jointly commit a tortious act causing damage to others, they shall bear joint and several liability.

When a CPA colludes with the issuer or issues an unqualified opinion while possessing actual knowledge of material misstatements, the nature of their conduct exceeds the scope of mere intermediary services and constitutes a direct infringement of investor rights. In such scenarios, a “meeting of minds” exists between the accounting firm and the issuer. This involves not only extreme subjective malice but also objectively results in the joint causation of the misrepresentation. Therefore, full joint and several liability must be strictly applied. Specifically, the accounting firm must be held liable for the entirety of investor losses and is precluded from claiming that its liability should be limited to the scope of its audit fees or its proportionate fault. This stringent liability allocation aims to send a clear regulatory signal of “zero tolerance” to the market, thereby curbing moral hazards—such as audit collusion—by significantly imposing prohibitive costs on such misconduct.

5.2. Gross Negligence: Introduction of Proportionate Joint and Several Liability

With respect to gross negligence by accounting firms, the current judicial practice of directly imposing full joint and several liability lacks a sound jurisprudential basis [13]. Although gross negligence signifies a serious deviation from professional standards, it remains qualitatively distinct from intent, which involves the willful pursuit of harmful consequences. Moreover, such conduct typically manifests as an omission consisting in the failure to detect fraud. Compared with the issuer’s active fraudulent conduct, audit negligence occupies only a secondary position in terms of causative potency.

Accordingly, drawing on the legislative experience of mature capital markets, a system of proportionate joint and several liability should be introduced [14]. Under this approach, courts would expressly specify in their judgments that accounting firms bear joint and several liability with issuers only within a defined percentage range. Such an institutional arrangement can be accommodated within the interpretative framework of Article 85 of the Securities Law. Although this provision establishes the principle of joint and several liability, it does not, as a matter of textual interpretation, expressly prohibit the application of proportionate joint and several liability. Consistent with the fundamental principles of fault-based liability, courts should therefore be permitted, when interpreting and applying this provision, to delineate the concrete scope of joint and several liability according to the intermediary’s degree of fault, rather than mechanically equating it with full joint and several liability [15].

In practical application, courts should exercise discretion to determine a reasonable proportion of joint and several liability based on the audit institution’s causal contribution to the resulting damage. Within this proportion, investors may claim joint and several compensation from the accounting firm. The introduction of proportionate joint and several liability ensures that audit institutions bear substantial legal consequences for serious dereliction of duty, while avoiding their transformation into the ultimate guarantor of the issuer’s entire debt. It thus reflects a legislative approach that strikes a prudent balance between deterrence and protection.

5.3. Ordinary Negligence: Exploration of Supplementary Compensation Liability

A key innovation in constructing a tiered liability system lies in establishing supplementary compensation liability for ordinary negligence. Where accounting firms exhibit only ordinary

negligence-such as sampling bias or defects in audit working papers-imposing joint and several liability on them would result in a severe imbalance between fault and liability.

Under civil law principles, audit institutions, as gatekeepers, are subject to a duty of care aimed at preventing harm caused by others (conceptualized as a “security-guarantee obligation” in civil law jurisprudence). In situations where the issuer commits financial fraud as a direct infringer, while the audit institution fails to detect such fraud due to ordinary negligence, the legal relationship between the two should be characterized as non-genuine joint liability, or more precisely, a supplementary liability relationship.

Accordingly, accounting firms should be granted the right to invoke prior exhaustion of remedies against the primary wrongdoer (the benefit of discussion) or priority in the order of execution. Investors, when seeking compensation, must first exhaust enforcement measures against the issuer and its actual controllers as primary liable parties. Only where the assets of these primary responsible subjects remain insufficient to satisfy the debt after lawful compulsory execution should the accounting firm bear supplementary compensation liability, and only within the scope of its fault. This design of liability accurately reflects the objective reality that audit institutions play merely a secondary and auxiliary role in securities misrepresentation. It also effectively prevents the moral hazard of investors bypassing the primary wrongdoer and transferring risk directly to intermediary institutions.

5.4. A System of Judicial Discretionary Factors for Liability Proportion

To ensure the precise apportionment of proportionate joint and several liability and supplementary compensation liability in individual cases, and to curb the arbitrariness of judicial discretion, it is necessary to establish a framework of discretionary factors incorporating multidimensional assessment criteria, rather than relying on rigid mathematical formulas.

First, causative potency constitutes the central discretionary factor. Courts should examine the substantive impact of audit fault on investors’ decision-making and the occurrence of losses. Where the misstated item represents only a small proportion of total assets, or where the auditor’s procedural deficiencies were not the direct cause of the failure to detect the misrepresentation, the liability proportion should be reduced correspondingly.

Second, the nature and degree of fault must be taken into account. Judicial discretion should draw a substantive distinction between the absence of core audit procedures and technical defects. For gross negligence involving the failure to perform core procedures-such as external confirmation or inventory observation-a higher proportion of joint and several liability should be applied. By contrast, for ordinary negligence involving merely formal defects in audit documentation, a lower proportion of supplementary compensation should be imposed.

Third, the balance between risk and reward, as well as industry-level risk, should be considered. In accordance with the principle of equivalence between risk and return, courts should examine the proportional relationship between audit fees and potential compensation exposure. Although low fees cannot serve as a ground for exemption from liability, when determining the apportionment of liability for negligence, courts should consider whether the compensation amount significantly exceeds the consideration for audit services and the industry’s average risk-bearing capacity. This approach helps prevent the excessive use of punitive logic in civil tort adjudication and mitigates the systemic risk of audit firm insolvency triggered by individual cases.

6. CONCLUSION

The institutional dilemma surrounding the civil liability of accounting firms in securities misrepresentation is, in essence, the result of friction and conflict at a specific developmental stage

between the logic of intensified regulatory enforcement in the Securities Law and the principle of proportionality between fault and liability embedded in the Civil Code. Through an integrated analysis of normative gaps and judicial practice, this paper identifies the core problem of the current regime as the legislature's failure to fully incorporate the inherent attribute of reasonable assurance in the auditing profession, which in turn has led to the absence of a graduated structure of fault determination. At the judicial level, constrained by the audit expectation gap and professional technical barriers, courts have been trapped in a discretionary predicament of inferring fault retrospectively from outcomes. This distortion of the liability determination mechanism has not only generated de facto guarantor liability but has also misallocated audit resources, thereby undermining the substantive effectiveness of the capital market's gatekeeper function.

In response, the tiered liability reconstruction proposed in this paper does not seek to confer extra-legal privileges upon accounting firms. Rather, it aims to restore equity and justice within the framework of fault-based liability. By establishing a tripartite fault system-intent, gross negligence, and ordinary negligence-and aligning it with three differentiated forms of liability (full joint and several liability, proportionate joint and several liability, and supplementary compensation), the proposal transcends the rigid binary model of liability attribution. This institutional design simultaneously addresses the practical need for investor remedies and preserves a necessary margin of professional tolerance for audit institutions, thereby avoiding industry contraction or the proliferation of defensive auditing caused by excessive liability exposure.

In the long run, refining the civil liability regime for accounting firms constitutes an essential condition for building a capital market that is standardized, transparent, open, dynamic, and resilient. In the context of the ongoing deepening of registration-based IPO reform, only by precisely aligning legal liability with professional function-neither condoning dereliction of duty nor imposing unlimited liability beyond the scope of fault-can audit institutions be guided back to their core role as professional gatekeepers, thereby achieving a stable and sustainable market ecosystem defined by clear rights, responsibilities, and shared risks. Achieving this objective requires coordinated efforts among legislative, judicial, and regulatory authorities. Through the refinement of legal norms and the exercise of specialized judicial discretion, these institutions can jointly uphold the rule-of-law order of the capital market.

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