

# AUDITORS' CIVIL LIABILITY TOWARDS CLIENTS UNDER THE JORDANIAN LAW: LEGAL AND AUDITING PERSPECTIVES

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## Abstract

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Since the emergence of the profession, auditors' liability is recognized as a controversial and loose debating matter (Flores, 2011). This everlasting issue not only differs among contexts but also differ among the lawsuits. Consequently, as an essential step, this research endeavors to provide a full understanding of the extent and nature of auditors' legal liability according to the Jordanian relevant regulations. To do so, the authors gain a full capture of the regulation through a qualitative-analytical study. Consequently, the authors found that in Jordan auditors are subject to different standards of proof before the judiciary. Therefore, judges in Jordan are bound to understand the peculiar technical-legal nature of auditors' liability. Although the Jordanian regulations state clearly that an auditor is obliged to compensate for any realized damage or lost profit incurred as a result of errors committed by him/her, it must be borne in mind that lost profit is not recognized, and therefore, not entitled to compensation under the Jordanian Contract Law. In some cases, auditors' liability might be increased to one of fitness for intended purposes, instead of reasonable care. Undoubtedly, this paper has serious legal implications in construing the wording of legal provisions and ensuing obligations and liabilities thereof.

**Keywords:** Fitness for Intended Purposes, Reasonable Care Obligations, the Jordanian Civil Code, Tort, Contract

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## 1. INTRODUCTION

The discussion on what might be considered as an auditor wrongdoing is wide (Arena & Azzone, 2009; Gold, Gronewold, & Pott, 2012). This is fundamentally originated from the renewed discussion on the expectation gap theory that explains the debate on misconception over the auditor-clients relationship (Gold et al., 2012; Mamede, Schmidt, & Rikers, 2007). Audit failure is deemed to be a great challenge for auditors

(De Fuentes & Porcuna, 2019; Leaver, Seabrooke, Stausholm, & Wigan, 2020; Lowe, Reckers, & Whitedcotton, 2002). Failure to comply with the enforced auditing standards is a major type of audit failure that might result in sever legal sanctions. In the efforts for safeguarding the auditors, international regulatory authorities such as the Public Company Accounting Oversight Board (PCAOB) and International Auditing and Assurance Standards Board (IAASB) have issued multiple standards to guide the professional in conducting high quality auditing.

In the last few decades, audit standards setters have shown progressive views toward what an auditor might be responsible for (Gimbar, Hansen, & Ozlanski, 2016; Lowe et al., 2002; Napier, 1998; Pratoomsuwan & Yolrabil, 2020). In general, auditors in a developing country context face challenges regarding compliance with the international audit standards. This situation is greater in the Jordanian context (Abdullatif, 2016; Abdullatif & Al-Rahahleh, 2020; Farooq, Kazim, Usman, & Latif, 2018). Liability is one of the main factors that promote audit quality. The auditor liability regime is dependent on the general rules of civil law that determine the compensation of harmed persons (Flores, 2011). The case law on auditors' liability in Jordan is very limited. This reflects the scarcity of litigation in Jordan with regards to this vital issue. Accordingly, the authors of this paper will take a speculative approach, which might be utilized by Jordanian judges on this matter.

This article contributes to the literature in three main ways: first, understanding the nature of auditors' liability under the Jordanian law; second, understanding the parameters of measuring compensation in cases of auditors' liability in Jordan; and third, understanding a case on auditors' liability under consideration by the Jordanian judiciary to assess how Jordanian judges might approach this matter.

The remainder of this paper is organized as follows: Section 2 reviews the literature on auditor liability from a professional perspective, Section 3 illustrates the methodological assumptions of this paper, Section 4 provides the research's findings, Section 5 discusses these findings, and Section 6 concludes the paper.

## 2. LITERATURE REVIEW

Since the Enron collapse and the subsequent big corporate scandals, regulators, policymakers, academics, and researchers have put considerable efforts to encounter the auditor-client relationship and auditor responsibility and liability engagement (Alhusban et al., 2020; Choi, Kim, Qiu, & Zang, 2008; Gietzmann & Quick, 1998; Grenier, Reffett, Simon, & Warne, 2018; Zerban, 2018). Recently the IAASB issued the International Standard on Auditing No. 701 (ISA 701), the Key Audit Matters (KAMs), which is in response to the calls from different audit-interested stakeholders to mitigate the risk of negative judgments of auditor liability (Abdullatif & Al-Rahahleh, 2020; Pinto & Morais, 2019; Pratoomsuwan & Yolrabil, 2020). Contradictory to the belief that disclosing more information in the auditor report may increase the jurors' auditor liability, Brasel, Doxey, Grenier, and Reffett (2016) found that the disclosure of the critical audit matters reduces the jurors' auditor liability as jurymen recognize that undetected deceitful misstatement was more foreseeable to the plaintiff. In addition, Brasel et al. (2016) report that disclosure of critical audit matters reduces auditors' liability for undetected misstatements.

Auditor liability is a controversial issue in many contexts worldwide. For example, in the United Kingdom, auditors are forbidden by law from contracting with organizations for their liability to be restricted (Napier, 1998; Wortham, Liebscher, & Christian, 2020). In Jordan, the regulatory was silent

on the auditor liability, Abdullatif and Al-Rahahleh (2020) narrated:

"...since detailed responsibilities of auditors and contents of their reports are determined directly by ISA, which use became mandatory for auditing Jordanian public listed companies since 1998 under JSC instructions (JSC, 1998). The same instructions made it mandatory for Jordanian public listed companies to use IFRS in preparing their financial statements" (p. 273).

Auditor liability is a loose matter as the jurors' auditor liability judgments are fluctuated among different cases based on the obtained preceded information and disclosures by the auditor from the client (Abdullatif & Al-Rahahleh, 2020; Brasel et al., 2016; Pratoomsuwan & Yolrabil, 2020). In addition, the auditor liability differs among the lawsuits as the jurors' auditor liability could be affected by the course of actions taken by the auditor during performing the audit process (Alderman, 2020; Brown, Majors, & Peecher, 2020; Louis, Pearson, Robinson, Robinson, & Sun, 2019).

What we can learn from the literature is that auditor liability is not a new debating issue, nor consistent among different countries' legislation (Gietzmann & Quick, 1998; Gold et al., 2012; Napier, 1998; Velte & Eulerich, 2014; Velte & Stiglbauer, 2012). Moreover, from the literature, it is evident that the audit failure is not a self-contained issue that interests only a limited community. In contradiction, it is a well-recognized matter for its harmful effect on the third party once it involves negligence (Choudhary & Gupta, 2019; Grenier et al., 2018; Lowe et al., 2002; Lytton, 2019; Mićović & Puvāca, 2018; Napier, 1998). Finally, in literature, auditor liability studies have greatly focused on the developed countries context, leaving behind the developing countries contexts as non-researched contexts (Abdullatif & Al-Rahahleh, 2020; Pratoomsuwan & Yolrabil, 2020).

## 3. RESEARCH METHODOLOGY

Given the exploratory nature of this research and that the auditing profession in Jordan is, to date, relatively unexplored, a qualitative method approach was adopted (Creswell, 2014; Saldaña, 2015; Silverman, 2015). Data for this paper were obtained from two different streams. First, the Jordanian laws and regulations were reviewed. The authors have selected articles that can be suitable to judge the extent and nature of auditors' legal liability. Table 1 shows the selected laws and law articles. Second, the authors selected a lawsuit from Jordanian courts on the auditors' legal liability matter.

Table 1. Data sources

Regulation	Article(s)	Reason for selection
The Companies Law No. 22 of 1997 and its amendments	201	This article addresses the auditors' legal liability.
	202	This article addresses the confidentiality issue of the client's information.
The Jordanian Civil Code	266	This article addresses the damage and loss of profit in the compensation issue.
The Jordanian Civil Code	363	This article addresses the damage and loss of profit in the contractual context.

To analyze the selected data, this paper used the thematic analysis technique (Aronson, 1995; Braun & Clarke, 2006). This approach to analysis involves multiple sequenced steps. First and foremost, the researchers reviewed all the auditing and accounting relevant regulations and the regulations in relation to the loss of profit compensations. Secondly, an initial examination of the regulations has been conducted by the authors to construct their own understanding of the current Jordanian auditors' liability. The third step in the analysis process encompassed constructing the potential themes. In the final step, the overall story of the data was built, and the findings report was written.

#### 4. FINDINGS

Our analysis of the auditor's legal liability through the obtained data has yielded five main themes according to our conceptual plan. These themes are as follows:

- auditors' liability: fitness for intended purposes vs. reasonable care obligations;
- auditors' liability: Contract Law vs. Tort Law;
- a case study from the Jordanian courts;
- law in motion: Contract Law vs. Tort Law;
- law into practice: fitness for intended purposes vs. reasonable care obligations.

##### 4.1. Auditors' liability: Fitness for intended purposes vs. reasonable care obligations

In the Jordanian law, contractual obligations can be categorized under obligations to "achieve specific results" whereby a party would not be released from his/her obligation(s) unless the materialization of such result. Such obligation might be termed as "fitness for intended purposes". In this scenario, the auditor remains free to decide how to achieve the result. Ultimately, contractual responsibility would arise if there is non-performance, delayed performance, or defective performance, without the need to prove any wrongdoing or negligence. The other category of obligations is an obligation to perform a duty of reasonable care whereby liability arises only if there is negligence. Such obligation might be termed as "duty of care". In this case, there is an emphasis on the "ordinary man" as the measuring stick for one's performance.

The traditional approach in the Jordanian law is that normally the law does not imply terms of fitness for purpose into contracts for professional services, such as auditors, as a professional man does not normally undertake an unqualified obligation to produce the desired result. Instead, an auditor is expected to use reasonable care and skill in performing his assigned task. This coincides to a large extent with the common law stance on this matter. Lord Diplock, in *Saif Ali v. Sydney Mitchell & Co.* (as cited in Schofield 1997, p. 73), stated unequivocally:

*"No matter what profession it may be, the common law does not impose on those who practice it any liability for damage resulting from what in the result turn out to be errors of judgment, unless the error was such as no reasonably well informed and competent member of that profession could have made"*.

EC Recommendation 2008/473/EC of June 5, 2008, concerning the limitation of the civil liability of auditors in Europe affirmed limitation of liability by agreement between the auditor and his/her client. Arguably, the Jordanian law does not appear to contemplate the possibility that auditors' liability might be increased to one of fitness for intended purposes, instead of reasonable care. Evidently, the absence of such contemplation might be attributed mainly to apparent disregard to the degree of risk normally associated with auditors' task, and most importantly, his/her ability to maneuver and influence the performance of such task. In view of the above, practically speaking, it is for the court to determine the limits of the acts qualifying for auditors' liability and the presence of any of the grounds for relieving him/her of liability. By extending the logic, this implies that an auditor might be subject to different standards of proof before the judiciary.

In response, the authors suggest that it is imperative to have clear rules and regulations whereby if one party is holding itself out as an expert in a particular field and that the other party relies upon that expertise to its detriment, the former would be liable for losses caused. Essentially, this implies that auditors' liability might be increased to one of fitness for intended purposes, instead of reasonable care. This would be particularly true if an auditor has comprehensive access to financial records and statements of a given company, whereby such access implies a high potentiality of forming informed and educated judgment in performing his/her presumed task. Thus, establishing an exception to the restrictive approach of liability normally adopted by the Jordanian courts.

##### 4.2. Auditors' liability: Contract Law vs. Tort Law

Auditors' liability is addressed in articles 201 and 202 of the Jordanian Companies Act (hereinafter referred to as JCA)<sup>1</sup>. Article 201 provides:

*"Auditors shall be liable towards the company which he audits its accounts, its shareholders, and the users of its financial statements for compensating any realized damage or lost profit incurred as a result of errors committed by him/her while carrying out his/her duties, or as a result of his/her failure to accomplish his/her duties that are specified in accordance with the provisions of this law, and the provisions of any other legislation in force, or duties demanded by internationally recognized accounting and auditing standards, or as a result of issuing financial statements that do not conform with reality in a major manner or for approving these statements"* (Article 201, JCA).

In the same context, article 202 of the JCA prohibits *"...any disclosure of any secrets of the company that came to the auditor's knowledge in the course of his/her duty, either to shareholders or non-shareholders, otherwise he shall be dismissed and requested to compensate the damages"* (Article 202, JCA).

Under the Jordanian law, the applicability of the aforementioned articles as special legal provisions related specifically to auditors' liability is

<sup>1</sup> The Companies Law No. 22 of 1997 and its amendments.

both qualified by reference to the general rules of compensation provided in the Jordanian Civil Code (hereinafter referred to as JCC)<sup>2</sup>. In this regard, under the Jordanian law, generally speaking, the Jordanian legislature states that every injurious act shall render the person who commits it liable for damages<sup>3</sup>. Article 266 of the JCC states “*that damages shall in all cases be estimated by the amount of the damage inflicted on the injured person and his/her loss of profit and loss of revenue provided that the same shall be the natural result of the injurious act*” (Article 266, JCC).

However, as demonstrated above, auditors are subject to contractual liability rather than tortious liability under the Jordanian law<sup>4</sup>. From this perspective, article 363 of the JCC states:

*“If the damages shall not be estimated in the contract or the law, the court shall estimate them as those equal to the actual damage at the time it was inflicted”* (Article 363, JCC).

In stark contrast with the wording of articles 201 and 202 of the JCA, which state clearly that an auditor is obliged to compensate for any realized damage or lost profit incurred as a result of errors committed by him/her, it must be borne in mind that lost profit is not recognized, and, therefore, not entitled for compensation under the Jordanian Contract Law according to article 363 of the JCC abovementioned. Having said that, legal scholars in Jordan had opined that, given special provisions of the JCA confines, circumvents, and restricts the applicability of general provisions of the JCC, articles 201 and 202 of the JCA are in conformity with article 363 of the JCC<sup>5</sup>.

#### 4.3. A case study from the Jordanian courts

In *Hadley v. Baxendale* (1854), one of the leading cases in common law countries, and particularly in England, a shaft in the claimant’s mill had broken and had to be sent to the maker to serve as a pattern for the production of a new one. The maker delayed doing so, and the work in the claimant’s mill was prevented several days. The claimant claimed damages for loss of profits during the period. The court concluded that the maker of a defective mill shaft was not responsible for the mill’s lost revenues while it was shut down awaiting delivery of a new mill<sup>6</sup>.

Bearing this in mind, in a landmark case brought before the Court of Cassation in Jordan, the auditor, which is a well-known international auditing firm, failed to perform its contractual duties towards a Jordanian company, which is a local bank, whereby the latter decided to bring legal action to that effect. The amount of claim was estimated to be around 17 million Jordanian dinars (this equals 24 million US dollars). Until now, the final judicial decree is still pending<sup>7</sup>.

#### 4.4. Law in motion: Contract Law vs. Tort Law

In the opening statement at the trial, the claimant contended that the defendant’s recklessness and lack of adherence to International Standards of Auditing (ISA), which was manifested in the act of misappropriation of the claimant assets, is liable for compensation. The old rhetoric that the auditor is liable for compensating any realized damage or lost profit incurred as a result of errors committed by him/her while carrying out his/her duties was recited by the claimant against the defendant’s allegations.

If the defendant is found to be responsible for the claimant’s allegations, the authors would not be surprised if the court proceedings go further and conclude to reject the defendant’s contention and establishes that the defaulting auditor is responsible for paying realized damage or lost profit to the claimant. Apparently, the court potential proposition to award realized damage or lost profit to the defendant might be paradoxical, at least at a theoretical level, due to the fact that there are no limits imposed on addition, omission, or modification of a contractual obligation as this is not considered a matter of public policy in Jordan (Haloush, 2020). In effect, it may be agreed to vindicate the auditor of any responsibility resulting from non-performance or delayed performance of contractual obligations except that which arises from fraud or gross negligence<sup>8</sup>.

In this context, the dilemma might be duplicated if one bears in mind that, according to the Jordanian law, if a contractual fault is coupled with deceit or gross negligence, tortious responsibility would come into play instead of contractual liability (culpability test)<sup>9</sup>. The authors submit to the view that, under the Jordanian Contract Law, deceit or gross negligence are high verges to meet. However, in this scenario, in addition to allowing tort law to be subservive of contractual obligations, the potential harm may well result in an auditor’s tortious liability, which is the main source of fear among the profession because of the elevated amount of damages it could generate (Flores, 2011).

#### 4.5. Law into practice: Fitness for intended purposes vs. reasonable care obligations

In this case, the paradox might even be exacerbated since the claimant stated unequivocally that the defendant had full and unqualified access to all relevant accounting and financial statements, board of directors and shareholders’ meetings, internal auditing memorandums, and all necessary and relevant communications with the Jordanian Central Bank. This is particularly important if one bears in mind that the court’s line of reasoning would be most probably based on a normal “duty of care” parameters of the defendant mentioned above, instead of going into a thorough excavation on the degree of the defendant ability to access financial records and statements of the claimant

<sup>2</sup> The Jordanian Civil Code No. 1 of 1976, published in the Jordanian Official Gazette No. 2645 (1976).

<sup>3</sup> See, e.g., the Jordanian Court of Cassation, Case No. 6213/2019. See also, the Jordanian Court of Cassation, Case No. 2084/2019.

<sup>4</sup> See, e.g., the Jordanian Court of Cassation, Case No. 7016/2019. See also, the Jordanian Court of Cassation, Case No. 4953/2019; the Jordanian Court of Cassation, Case No. 475/1999.

<sup>5</sup> Article 1448(2) of the JCC. The article reads as follows, “the provisions of special laws shall be complied with when applying the provisions of this Code”. See also, the Jordanian Court of Cassation, Case No. 289/1988.

<sup>6</sup> *Hadley v. Baxendale*, 156 ER 145 (1854).

<sup>7</sup> The Jordanian Court of Cassation, Case No. 3308/2020.

<sup>8</sup> Article 270 of the JCC states that any condition for exemption from the liability resulting from the injurious act shall be void. See, e.g., the Jordanian Court of Cassation, Case No. 2566/2019. See also, the Jordanian Court of Cassation, Case No. 6821/2018.

<sup>9</sup> Article 358(2) of the JCC. The article reads as follows: “In any case, the debtor shall remain liable for his deceit or gross negligence”.

in order to establish a higher threshold of liability. A critical examination of the defendant's culpability and the significance of such a factor in causing the damage would not be typically conducted by Jordanian courts.

As an observation, traditionally, all common law jurisdictions adopted a restrictive approach towards claims interfaces with various levels of defendant's level of discovery, disclosure, or lack of non-disclosure of confidential information, and the intertwined possibility of the defendant capability of excavating deeply into such information, all of which are inherently interconnected with an appropriate level of expertise.

In particular, where one party is holding itself out as an expert in a particular field, such as an auditor, and that the other party relies upon that expertise to its detriment, the former would be liable for losses caused. Although the Jordanian law perceives auditors as possessing better technical skills than other litigants in a court of law who are non-specialists in auditing and accordingly in desperate need for protection, level of expertise, or more precisely, the ambit of reference of the expert, is not recognized, and therefore, not entitled for compensation under the Jordanian law. This represents a dislocation between the skill that was contractually assumed and the quality of work to be expected (Schofield, 1997). Undoubtedly, this might have serious legal implications in construing the wording of legal provisions and ensuing obligations and liabilities thereof.

## 5. DISCUSSION

In Jordan, auditors might be subject to different standards of proof before the judiciary. The auditors' liability might be increased to one of fitness for intended purposes, instead of reasonable care. This is true if an auditor has comprehensive access to financial records and statements of the clients; such access indicates the high potentiality of an exception to the restrictive approach of liability normally adopted by the Jordanian courts. Under the Jordanian Contract Law, deceit or gross negligence are high verges to meet. In this scenario, the potential harm may well result in an auditor's tortuous liability, which elevates the amount of damages it could generate (Flores, 2011).

In an attempt to propose a possible scenario for the defendant's response(s) to the claimant's allegations, the authors of this paper would argue that, presumably, the existence or lack of existence of fraud or gross negligence by the defendant would be in the forefront of claimant's allegations in this case. In response, if an inadequate level of access ability to confidential information of the company has been demonstrated, the defendant might resort to the concurrent causation notion in the JCC encapsulated in article 265 of the JCC. The article provides that if the persons responsible for the injurious act shall be several, every one of them shall be liable for his/her share therein, and the court may rule between them equally or jointly (Article 265 of the JCC).

In practical terms, judges ought to evaluate reasonably and rationally the degree of culpability of each cause and the significance of each factor,

whereby damages may be reduced due to the plaintiff's contributory negligence. Having said that, in the authors' view, a deep excavation on the degree of culpability of each cause and the significance of each factor might not be performed by Jordanian courts. By the same token, if an auditor had full and unqualified access to the company's confidential information, who is presumably aware of the significance of such information as an indispensable tool to proceed with his/her assigned task of auditing, then a Jordanian court would presumably allocate more liability to the auditor (Article 265 of the JCC).

## 6. CONCLUSION

Auditors' liability is not only a legal issue. It is also a technical challenge to which an interdisciplinary body of legal scholars and auditors should respond. The issue of what is the recoverable loss is legal, but the interpretation of what is that loss into an identifiable sum is for the accountants (Article 265 of the JCC). Lawyers often devote considerable efforts in dealing with the liability side of the case, with less attention spent on considering the damages aspects. Even when damages issues are considered, without the advice of an expert, the lawyers may fail to obtain the necessary documents to support the damages calculations (Brennan, 2005). As a result, judges in Jordan are bound to understand the peculiar technical-legal nature of auditors' liability. This should be a good starting point for developing case law in the field. In this way, case law can be established gradually and cumulatively on a case by case basis (Haloush, 2020).

As with all research, this research is associated with few research limitations. The Jordanian Civil Code was drafted more than 44 years ago and needed revision. Auditors' liability is not addressed by any single article under the Jordanian law. Furthermore, readers should keep in mind that there is presently very little if non-existent case law dealing directly with auditors' liability in Jordan. They should keep in mind also that the issue of civil liability that includes tortuous and contractual liability, by its very nature, compels as broad and comprehensive an analysis as possible. In addition, there are few empirical studies to deal with the auditor's legal liability in the Jordanian context. The lack of such research impacts our understanding of this phenomenon as much work should be done to encounter all the aspects of auditors' legal liability in the Jordanian context.

The findings from this study substantiate the need for further research on auditors' liability in Jordan. The legal system in Jordan is in its infancy and has a long way to attain maturity. This article has been conducted after doing extensive research on auditors' liability in Jordan. At that point, the authors were able to decide on what constitutes by far the most controversial and delicate issues related to auditors' liability in Jordan in order to canvass the opinions of academics and practitioners on this issue. Accordingly, future researchers on auditors' liability could set up a survey conducted with academics and practitioners involved in auditors' liability in Jordan in order to gather their opinions since surveys measure the degree of favorability towards the subjects in question.

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