Proportional Joint and Several Liability of Auditing Institutions in Securities Misrepresentation Civil Compensation Cases

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Abstract: In civil compensation cases involving securities misrepresentation, the proportional joint and several liability of auditing institutions lacks a uniform standard of determination, resulting in vastly divergent adjudicative outcomes. Although existing regulations distinguish between intentional and negligent fault, there remain significant regulatory gaps in three critical areas: the criteria for differentiating between intent and negligence, the internal classification of degrees of negligence, and the benchmark for determining liability proportions. Judicial practice, as exemplified by the Huaze Cobalt-Nickel case, the Kangmei Pharmaceutical case, and the Zhong'anke case, reveals that the structural causes of inconsistent adjudication lie in the absence of uniform standards for fault characterization, uniform methods for proportion determination, and uniform guidance on value orientation. Drawing on a comparative study of the U.S. Private Securities Litigation Reform Act (PSLRA) and Australia's CLERP 9, this article proposes a dual liability structure of "full joint and several liability—proportional joint and several liability" demarcated by the auditing institution's subjective state of mind; a four-dimensional framework for proportion determination encompassing the degree of fault, the relevance of misrepresentation content, the impact on investor decision-making, and the auditing institution's compliance efforts; and institutional safeguards consisting of third-party professional assistance in adjudication and mandatory professional liability insurance, thereby providing an operationalizable rule-based pathway for the determination of proportional joint and several liability.

Keywords: Securities Misrepresentation; Auditing Institutions; Proportional Joint and Several Liability; Fault Determination; Investor Protection

1. Statement of the Problem

The origins of this question are normative. Article 163 of the Securities Law stipulates that securities service institutions shall bear joint and several liability with the principal, but does not distinguish between full joint and several liability and proportional joint and several liability. Article 13 of the 2022 Provisions on Misrepresentation differentiates the fault of auditing institutions into intent and negligence, providing that in cases of negligence, the institution shall bear "corresponding liability for compensation," but what constitutes "corresponding" and how the proportion is to be determined remain unspecified in the judicial interpretation. This regulatory void renders proportion determination highly dependent on case-by-case discretion in practice, with different courts arriving at vastly divergent outcomes based on differing understandings of the nature of fault. The Huaze Cobalt-Nickel case is exemplary: the Chengdu Intermediate People's Court at first instance determined that Ruihua shall bear proportional joint and several liability at 60%, while the Sichuan Higher People's Court on appeal reversed this to full joint and several liability on the ground that "should have known" constitutes joint tortious conduct. The two courts, confronting identical facts, reached diametrically opposite conclusions—the root cause being the absence of operationalizable criteria for delineating the boundary between "intent" and "negligence."

This is not merely a question of adjudicative technique; it also implicates deeper tensions within the securities tort liability regime. Full joint and several liability certainly serves to reinforce "gatekeeper" deterrence and protect investor interests, but it may also expose auditing institutions to compensation risks disproportionate to their fault—the collective withdrawal of partners from ZZJ following the

Kangmei Pharmaceutical judgment and the resulting loss of practice capacity illustrate this point. Proportional joint and several liability, while more consistent with the jurisprudential principle that liability should correspond to fault, risks leading to inadequate investor compensation in the absence of complementary investor relief mechanisms. How to establish a set of proportion determination rules that balances deterrence and fairness between these two poles is an urgent challenge for the current securities misrepresentation civil compensation regime.

The fundamental position of this article is as follows: the application of proportional joint and several liability should be demarcated by the subjective state of mind of the auditing institution—intentional participation in fraud triggers full joint and several liability, while negligent conduct triggers proportional joint and several liability; the determination of the proportion should not rely on vague judicial discretion, but should be grounded in a multi-dimensional analytical framework centered on the degree of fault, complemented by the relevance of misrepresentation content, the impact on investor decision-making, and the auditing institution's compliance efforts. To substantiate this position, this article first examines the regulatory gaps in proportion determination within the existing normative framework, then distills the focal points and causes of adjudicative divergence through a survey of representative cases, and on this basis draws upon the institutional experiences of the U.S. PSLRA and Australia's CLERP 9, ultimately proposing specific rule recommendations for proportion determination together with supporting institutional arrangements.

2. Normative Review: The Regulatory Gap in Proportion Determination

The normative basis for auditing institutions' civil compensation liability in securities misrepresentation is primarily constituted by Article 163 of the Securities Law and Article 13 of the 2022 Provisions on Misrepresentation. The former establishes two basic rules: auditing institutions bear joint and several liability with the issuer, and auditing institutions may be exempted by proving their own absence of fault—that is, the principle of presumed fault applies. The latter further distinguishes between two forms of fault: for intentional participation in fraud, the institution bears joint and several liability with the issuer; for negligence, the institution bears "corresponding liability for compensation". From "uniform joint and several liability" to "differentiated treatment," the 2022 judicial interpretation marked a significant conceptual advance [1], but the regulatory supply for proportion determination stopped there.

Specifically, the existing normative framework leaves gaps in three critical areas. First, the criteria for differentiating between "intent" and "negligence" are unclear. The "presumption of fault" under Article 163 of the Securities Law addresses only whether the auditing institution bears liability, without involving the characterization of fault; the 2022 judicial interpretation, while introducing the distinction between intent and negligence, provides no operational guidance on the criteria for their determination. In particular, the concept of "should have known," which appears frequently in practice, remains normatively unresolved as to whether it falls under intent (constructive knowledge) or negligence (failure to exercise due diligence). Second, there is no internal classification of degrees of negligence. In practice, the forms of negligence exhibited by auditing institutions vary significantly—omitting a critical confirmation procedure and failing to maintain professional skepticism regarding anomalous responses, while both constituting "failure to exercise due diligence," differ markedly in the severity of fault. The existing regulations lump all negligent conduct under the rubric of "corresponding liability for compensation" without providing a method for converting fault severity into liability proportions. Third, the benchmark for proportion determination is unclear. "Corresponding" to what? Corresponding to all parties who should bear liability (including the issuer, other intermediaries, and relevant responsible individuals), or only to the defendants present in the case? Different benchmarks directly affect both the meaning and magnitude of the resulting proportional figure.

The regulatory gap is further exacerbated by the imperfect transition between old and new rules. The 2007 Provisions on Several Issues Concerning the Adjudication of Civil Tort Compensation Cases Involving Accounting

Firms in Audit Activities had explicitly distinguished between liability types for intent and negligence: joint and several liability for intentional conduct, and "supplementary liability" for negligence. The 2022 judicial interpretation replaced "supplementary liability" with "corresponding liability for compensation," and the two differ fundamentally in legal effect: supplementary liability is premised upon the principal debtor's inability to satisfy the obligation, whereas proportional joint and several liability imposes a parallel obligation to satisfy within the proportional range alongside the principal debtor. This transition itself constitutes a significant institutional advance, yet the relationship between the old and new rules has not been explicitly elucidated, further compounding the difficulty for adjudicators in selecting the appropriate type of liability.

It bears noting that any discussion of the proportional liability of auditing institutions cannot be divorced from their role in the capital market. Although retained by the issuer, auditing institutions produce audit reports that, as legally mandated disclosure documents, are publicly available to all investors, who reasonably rely upon them in making investment decisions. Auditing institutions thus bear a statutory duty of care that transcends the contractual relationship, a concept doctrinally summarized as the "gatekeeper" of the capital market [2,3]. However, the gatekeeper's function is to "detect and prevent" rather than to "guarantee"—auditing standards require auditors to obtain "reasonable assurance" rather than "absolute assurance," which means that auditing has inherent limitations, and strict compliance with auditing standards may still fail to identify elaborately orchestrated fraud. This basic consensus in audit theory carries two implications for liability proportion determination: on the one hand, the fault of auditing institutions should be assessed independently of that of the issuer, as the failure to detect fraud differs fundamentally in the nature of fault from complicity in fraud; on the other hand, the inherent limitations of auditing should serve as a factor constraining the liability proportion, and audit failure should not automatically be equated with subjective malice on the part of the auditing institution. Yet the existing regulations have neither translated this analytical logic into adjudicative rules, nor has judicial practice achieved consensus—some courts emphasize gatekeeping responsibility and favor higher compensation proportions, while others take the inherent limitations of auditing into account and adopt a more conservative stance. The root of this divergence remains the absence of uniform regulatory guidance on proportion determination.

3. Judicial Survey: Practical Divergence and Its Causes in Proportion Determination

Since the implementation of the 2022 Provisions on Misrepresentation, adjudicative outcomes in cases involving auditing institutions have exhibited a pronounced pattern of divergence. Observing the principal judgments that have become final, cases imposing full joint and several liability on auditing institutions far outnumber those imposing proportional liability, and the only landmark case establishing proportional joint and several liability through a final judgment is the Zhong'anke case. This asymmetric pattern is not in itself surprising—cases that proceed to litigation tend to involve more serious audit failures, providing a factual basis for courts to impose heavier liability—but the internal logical differences among adjudicative outcomes expose a regulatory impasse in proportion determination on three levels.

3.1 The Boundary between Intent and Negligence: The Divergence in Fault Characterization as Illustrated by the Huaze Cobalt-Nickel Case

The dividing line between full joint and several liability and proportional joint and several liability, at the normative level, depends on whether the auditing institution's fault is classified as intent or negligence. Yet this seemingly clear-cut dichotomy is far from easy to operationalize in adjudicative practice, as the Huaze Cobalt-Nickel case vividly demonstrates. At first instance, the Chengdu Intermediate People's Court determined that Ruihua's failure to detect Huaze Cobalt-Nickel's misappropriation of RMB 1.3 billion in listed company funds through large volumes of invalid photocopied invoices constituted negligent failure to exercise due diligence, and accordingly held Ruihua proportionally liable at 60%, with the sponsor GUOSEN Securities bearing 40%. On appeal, the Sichuan Higher People's Court concluded that the same facts

constituted "should have known" of the misrepresentation, satisfying the elements of joint tortious conduct, and revised Ruihua's liability proportion to 100%. The two courts relied upon the same CSRC administrative penalty decision and the same set of audit working papers, yet the first instance derived "negligence" while the appellate court derived "should have known" and equated it with joint tort—the fault characterizations were diametrically opposed.

The crux of this divergence lies in the dual nature of the concept "should have known." Textually, "should have known" is a negligence concept—one should have been aware according to professional standards but was not; functionally, however, it is frequently deployed as a tool for constructive intent—given the auditing institution's professional capacity, problems that should have been discovered but were not themselves evidence acquiescence. Different courts' classification of "should have known" directly causes the type of liability to leap from proportional joint and several liability to full joint and several liability. The Kangmei Pharmaceutical case similarly reflects this issue: the Guangzhou Intermediate People's Court imposed full joint and several liability on ZZJ on the ground that it "failed to implement the most basic audit procedures". Although the judgment did not expressly use the term "intent," the phrase "failed to implement the most basic procedures" implicitly contains a finding that the auditing institution adopted an attitude of acquiescence. In the Dazhihui case, the Supreme People's Court denied Lixin Accounting Firm's claim that its "minor negligence should warrant reduced liability" and upheld the judgment of full joint and several liability , yet the ruling similarly did not articulate a general standard for characterizing the nature of fault. It is thus apparent that existing case law provides case-specific conclusions rather than universally applicable rules of determination at the level of fault characterization.

3.2 The Determination of the Proportional Figure: The Absence of Methodology as Illustrated by the Zhong'anke Case

Even when fault is determined to be negligence and the case enters the zone of proportional joint and several liability, the question of how the specific proportion is to be derived from the degree of fault as a percentage figure equally lacks foreseeability. The Zhong'anke case is currently the only case to have demonstrated the reasoning process for proportion determination through a final judgment. On appeal, the Shanghai Higher People's Court revised Ruihua's liability to 15% (from full joint and several liability at first instance) , with reasoning encompassing three dimensions: on the nature of fault, no evidence indicated that Ruihua shared a common intent with, or had actual knowledge of, the issuer's conduct; on the content of misrepresentation, the inflated revenue of RMB 50 million from the "Smart Shiguai" project attributable to Ruihua accounted for merely 3.7% of operating revenue on a consolidated statement basis; and on the impact on investor decision-making, the project's influence on earnings forecasts and transaction pricing was weaker than that of other misrepresentation items in the case.

The identification of these three dimensions is itself groundbreaking, yet the derivation from analytical dimensions to a specific figure remains opaque. How the figure of 15% was arrived at from the above three factors is expressed in the judgment simply as "at the court's discretion." More critically, the benchmark underlying the 15% is also unclear: Zhong'anke Company and Zhong'anxiao Technology Company bore 60%, China Merchants Securities bore 25%, and Ruihua bore 15%, the three summing to 100%, but this 100% covers only the parties present in the case. The proportion of fault attributable to directors, supervisors, and senior management who did not participate in the litigation was not assessed. If their fault were included in the comparative range, Ruihua's proportion could be further reduced; if excluded, the defendants present in the case would effectively bear liability "on behalf of" the absent parties. Different choices of benchmark directly affect the meaning and fairness of the proportional figure.

Contrasting with the approach of the Zhong'anke case, the first-instance proportion allocation method in the Huaze Cobalt-Nickel case employed a "whose duty of care is higher" relative ranking between intermediaries, determining that the auditing institution's duty of care with respect to financial data exceeded that of the sponsor, and accordingly allocating 60% to the auditing institution and 40% to the sponsor. The logical starting point of this

method is a comparison of duties among intermediaries, rather than a comparison of the auditing institution's fault against the totality of losses—a fundamentally different methodological pathway from the three-dimensional analytical framework of the Zhong'anke case. Which method is superior is debatable, but the problem is that no regulation or guiding case currently provides methodological unification, making it virtually inevitable that different courts will proceed in their own ways.

3.3 Structural Causes of the Divergence

The adjudicative divergence described above is not accidental. In addition to the inadequate regulatory supply already discussed, at least two structural factors continue to exacerbate the divergence.

The first is the professional threshold for determining audit fault. Whether an auditing institution has exercised due diligence must be assessed against auditing standards and specific audit procedures, which is inherently highly technical. Judges typically lack professional expertise in auditing and are heavily reliant on CSRC administrative penalty decisions when determining fault. However, the starting point of administrative penalty decisions is administrative unlawfulness, not the degree of fault in the sense of civil tort law—they do not tell judges whether the auditing institution's fault constitutes "gross negligence" or "ordinary negligence," much less what proportion of civil compensation this fault should correspond to. The fact that two courts in the Huaze Cobalt-Nickel case arrived at diametrically opposite fault characterizations based on the same administrative penalty decision is rooted precisely in this: there is no conversion rule between administrative penalty findings and civil fault gradation, compelling judges to independently accomplish this "translation" from administrative determination to civil characterization—and different judges' "translations" naturally may diverge dramatically.

The second is the tension in values between investor protection and the sustainable development of the audit profession. Against the backdrop of full implementation of the registration-based IPO system and the policy orientation of "compelling gatekeepers to fulfill their responsibilities," there is a tendency toward imposing heavier compensation liability on auditing institutions; however, the realistic capacity of the audit profession to absorb such liability constitutes a countervailing constraint [4]. Following the Kangmei Pharmaceutical judgment, all partners of ZZJ collectively withdrew, and the firm lost its capacity to practice [5]; Ruihua, after being sued in multiple cases, experienced substantial partner departures and client attrition, declining from one of the top-ranked domestic firms to near-collapse. If excessive joint and several liability further reduces the number of firms capable of undertaking listed company audits, the ultimate casualty will be the overall quality of audit services in the capital market [6]. What judges face in individual cases is precisely this trade-off between the two values—in the absence of clear regulatory guidance, different value orientations will almost inevitably lead to different proportional outcomes.

Synthesizing the foregoing analysis, the substance of the current adjudicative divergence can be distilled into a single proposition: existing regulations have told judges "it is permissible to impose proportional liability," but have not told them "in what proportion." The absence of uniform standards for fault characterization, the absence of uniform methods for proportion determination, and the absence of uniform guidance on value orientation—these three compounded deficiencies make inconsistent adjudication a logical inevitability.

4. Comparative Reference: The Institutional Experiences of the United States and Australia

The three adjudicative dilemmas revealed above—the absence of uniform standards for fault characterization, the absence of uniform methods for proportion determination, and the absence of a bridging mechanism between proportional liability and investor protection—are not challenges unique to Chinese law. The United States in 1995 and Australia in 2004 respectively introduced proportional liability regimes for auditing institutions through legislation [7]; the institutional designs of both countries offer different yet complementary response models to the three problems identified.

4.1 Rule-Based Fault Characterization: The

"Knowingly" Demarcation of the PSLRA

The U.S. Private Securities Litigation Reform Act of 1995 (PSLRA) established a dual liability system in private securities fraud litigation demarcated by the defendant's subjective state: a defendant who "knowingly" violates securities laws bears joint and several liability for the plaintiff's entire loss; one who does not act "knowingly" bears only proportional liability corresponding to his or her percentage of fault. The immediate impetus for this design was the pre-reform reality under the joint and several liability regime in which "deep pocket" defendants such as auditing institutions—even when their degree of fault was far below that of the issuer—could be compelled to pay the full amount in compensation or forced into settlement [8].

The significance of the PSLRA for Chinese law lies not merely in the concept of "demarcation by subjective state"—Article 13 of the 2022 Provisions on Misrepresentation has already adopted a similar conceptual distinction—but rather in the specific manner in which the PSLRA translates this concept into operationalizable rules. "Knowingly" is a question of fact, determined by the jury on the basis of evidence, and the determination is recorded in the judgment, possessing verifiability and appealability. By contrast, the distinction between "intent" and "negligence" in Chinese law remains at the level of abstract concepts, lacking the support of a factual determination procedure—the diametrically opposed characterizations of the same facts by two courts in the Huaze Cobalt-Nickel case being a case in point.

To be sure, the PSLRA's "knowingly" standard has itself generated controversy in practice, the focal point being whether "recklessness" is equivalent to "knowingly." The federal circuit courts have long failed to reach consensus, and the Supreme Court in Tellabs discussed the evidentiary standard for a "strong inference" of scienter but did not provide a definitive answer on the recklessness issue [9]. This controversy resonates with the difficulty of categorizing the concept of "should have known" in Chinese law—in any legal tradition, the precise delineation between intent and gross negligence remains an institutional challenge. The experience of the PSLRA suggests that while this challenge cannot be entirely eliminated through legislation, it can be rendered basically foreseeable through proceduralizing the characterization question—assigning it to the fact-finder for case-by-case determination with explicit statement of reasons.

4.2 Proceduralization of Proportion Determination and Its Nexus with Investor Protection: The Complementary Experiences of the PSLRA and CLERP 9

On the question of how proportions are to be determined, the PSLRA provides a key procedural design: the law requires the fact-finder to make a written determination of each defendant's percentage of fault, and the scope of this determination extends beyond the defendants present in the case to encompass all responsible parties whose conduct bears a causal relationship to the plaintiff's loss. Each defendant's compensation amount equals the total judgment multiplied by the determined percentage of fault. [10] This "full-spectrum fault comparison" approach directly addresses the benchmark problem exposed by the Zhong'anke case: if proportions are allocated only among parties present in the case, the fault share attributable to non-participating parties is effectively borne by the defendants present—which is unfair to the latter. The PSLRA's approach is to include all responsible parties—whether or not they are parties to the action—within the scope of the fault comparison, ensuring that each defendant is liable only for the share corresponding to his or her own fault.

Proportional liability, however, gives rise to an unavoidable follow-on question: if a particular defendant is unable to pay his or her share, who fills the gap in investor losses? The PSLRA's response is a differentiated safety-valve mechanism: for small investors whose net worth is below USD 200,000 and whose losses exceed 10% of their net worth, other defendants bear joint and several liability for the uncollectible share; for other plaintiffs, each defendant's additional exposure is capped at 150% of that defendant's own share. Australia's 2004 CLERP 9 reform offers a complementary approach from a different angle. While introducing proportional liability (applicable only to negligence, excluding intent and fraud) , CLERP 9 simultaneously established a liability cap mechanism linked to audit fees and a mandatory professional liability insurance regime , which together constitute a dual "pressure relief valve" for auditing institutions'

civil liability. The reason the CLERP 9 reform secured acceptance from both the audit profession and investor protection constituencies lies in its character as a "package deal": proportional liability and the liability cap reduced the auditing institutions' compensation risk, while concurrently strengthened independence requirements, the legal enforceability of auditing standards, and audit rotation requirements enhanced audit quality constraints. Introducing proportional liability without simultaneously strengthening audit quality supervision would risk being criticized as weakening "gatekeeper" deterrence; the experience of CLERP 9 demonstrates that the two must be advanced as complementary measures in tandem.

4.3 The Limits of Comparative Reference

It must be noted that any transplantation of the foregoing institutional experiences must account for differences in institutional environments. The PSLRA's fault-percentage determination rests upon the United States' mature jury system and discovery procedures; whether Chinese courts, within the existing framework of tribunal organization and evidence rules, can achieve comparable precision in fault comparison is a practical constraint. Australia's liability cap and mandatory insurance regime are built upon a relatively well-developed professional liability insurance market, whereas the coverage rate and insured amounts of professional liability insurance for Chinese auditing institutions are conspicuously insufficient [11]. Accordingly, the rule recommendations proposed below will draw upon these experiences while making adaptive adjustments that account for the normative framework of China's Securities Law and the practical conditions of adjudication.

5. Rule Construction: An Analytical Framework for Determining Proportional Joint and Several Liability

5.1 Threshold Condition: Demarcation by the Subjective State of the Auditing Institution

Based on the normative review and judicial survey presented above, this article proposes that the subjective state of the auditing institution serve as the dividing line for establishing a dual liability structure of "full joint and several liability—proportional joint and several liability."

"Intentional participation in fraud" should be confined to two scenarios: first, where the auditing institution knows that the issuer's financial statements contain materially false entries and nevertheless issues an unqualified audit opinion; and second, where the auditing institution, in the course of audit procedures, has already identified anomalous signals clearly indicative of financial fraud but deliberately declines to pursue further inquiry or adjust the audit opinion, in substance acquiescing in the occurrence of the misrepresentation. In these two scenarios, the auditing institution's conduct constitutes a joint tort with the issuer, and the institution should bear joint and several liability for the entirety of investor losses. "Failure to exercise due diligence" refers to situations where the auditing institution harbors no such intent or acquiescence, but owing to violations of procedural requirements of auditing standards or a failure to maintain requisite professional skepticism, fails to detect material misstatements in the financial statements—its subjective state being negligence, to which proportional joint and several liability should apply.

The critical question this framework must address is the categorization of "should have known." As noted earlier, the appellate court in the Huaze Cobalt-Nickel case applied full joint and several liability on the ground that "should have known" constitutes joint tortious conduct, but "should have known" is logically a negligence concept—its meaning is "should have been aware according to professional standards but was not," rather than "actually knew." If all "should have known" scenarios are uniformly classified as joint tort, the scope for applying proportional joint and several liability would be drastically compressed, since the overwhelming majority of cases in which auditing institutions are sued can be characterized as "should have known"—this being precisely the essence of the "gatekeeper" duty. The position of this article is that "should have known" should in principle be classified within the domain of negligence, with proportional joint and several liability applying; only where the facts of the case demonstrate that the anomalous signals confronting the auditing institution were so conspicuous that the only reasonable explanation is that the

institution chose to turn a blind eye may intent in the form of acquiescence be presumed, with full joint and several liability applying. This standard draws upon the PSLRA jurisprudence that brings "reckless disregard" within the ambit of "knowingly," but through the higher evidentiary threshold of "only reasonable explanation," constrains the risk of negligence being improperly elevated to intent.

Applying this standard to the representative cases discussed above: in the Kangmei Pharmaceutical case, where the auditing institution failed for three consecutive years to perform bank confirmations—among the most basic of audit procedures—with respect to cumulatively inflated cash and cash equivalents of RMB 88.6 billion, the magnitude of audit failure is difficult to explain by negligence alone, and the presumption of intentional acquiescence with full joint and several liability is reasonable; in the Huaze Cobalt-Nickel case, where the issuer perpetrated fraud through forged photocopied invoices and the auditing institution failed to verify them in the absence of clear signals of fabrication, the circumstances more closely approximate gross negligence, and proportional joint and several liability would be appropriate; in the Zhong'anke case, where the scope of misrepresentation was limited and no evidence of intent or actual knowledge existed, the case is a paradigmatic instance of negligence.

5.2 Proportion Determination: A Four-Dimensional Analytical Framework

Once fault has been determined to be negligence, how the specific proportion is to be determined constitutes the second core question this article seeks to resolve. The Zhong'anke case considered three dimensions—degree of fault, relevance of misrepresentation content, and impact on investor decision-making—and its pioneering significance merits recognition, but the derivation of the 15% figure lacks transparency and reproducibility. This article proposes, building upon the Zhong'anke approach, a four-dimensional analytical framework to provide courts with a uniform analytical pathway for determining proportions in individual cases.

The core dimension is the degree of fault of the auditing institution, assessed by reference to the severity of violations of auditing standards. Negligence may be classified into three tiers: ordinary negligence, where the auditing institution has generally complied with the basic requirements of auditing standards but exhibits deficiencies in individual procedural steps, such as an inadequate sample size for confirmations or insufficiently thorough analytical procedures; gross negligence, where the auditing institution has omitted key procedures expressly required by auditing standards or has failed to maintain requisite professional skepticism in response to anomalous signals, such as the failure to conduct substantive testing of large-scale related-party transactions; and severe negligence, where the auditing institution has systematically failed to perform the procedures prescribed by auditing standards across multiple areas, or where the audit working papers record anomalies without any follow-up measures having been taken, approaching the boundary of intentional acquiescence. The three tiers correspond to different proportional ranges—ordinary negligence corresponding to the lower range, gross negligence to the middle range, and severe negligence to the upper range—providing "anchor points" for judicial discretion and enabling basic comparability across cases.

Beyond the degree of fault, three supplementary dimensions influence the final proportion. The first is the degree of relevance between the misrepresentation content and the audit scope. The auditing institution's liability should correspond to the scope covered by its professional duties: where the matter involves core financial statement line items directly covered by the audit report (such as revenue and cash and cash equivalents), the proportion should be higher; where it involves non-financial information not directly covered by the audit report, the proportion should be correspondingly lower. In the Zhong'anke case, Ruihua's inflated revenue constituted merely 3.7% of consolidated operating revenue—it was precisely this logic that yielded a lower proportion. The second is the degree of impact of the audit failure on investor decision-making, which concerns the strength of the causal nexus. Where the false information constitutes the primary basis for investor decisions (such as a material misstatement of core profitability metrics), the proportion should be higher; where the impact is relatively peripheral (such as a technical error in notes to the financial statements), the proportion should be lower. In

practice, reference may be made to objective indicators such as the fluctuation of securities prices around the date of the misrepresentation and the prominence of the false information within disclosure documents. The third is the auditing institution's own compliance efforts. Where the auditing institution can demonstrate that it has established a quality control system conforming to industry standards, conducted regular internal reviews and peer inspections, and provided adequate professional training to engagement team members, these compliance efforts should serve as a factor justifying a moderate reduction in the proportion; conversely, where the auditing institution itself suffers from systemic quality control deficiencies—such as long-term failure to rotate the engagement partner or failure to implement additional quality control procedures for high-risk clients—this should serve as a basis for increasing the proportion. The significance of introducing this dimension lies in the positive incentive it provides: auditing institutions that continuously improve audit quality can obtain a reasonable reduction in liability when audit failure occurs.

The four dimensions set forth above are not a mathematical formula for weighted summation, but rather a structured analytical framework. Their function is to require judges to articulate explicit reasoning on the specific considerations and conclusions for each dimension in their judgments, rendering the derivation of the proportion transparent and reviewable. Drawing on the experience of the PSLRA, this article recommends that courts state their findings and analysis for each defendant across the four dimensions on a dimension-by-dimension basis, transforming proportion determination from "conclusory discretion" to "reasoned adjudication." Simultaneously, the scope of the fault comparison should encompass all responsible parties whose conduct bears a causal relationship to investor losses—including the issuer's directors, supervisors, and senior management who did not participate in the litigation—rather than being limited to the parties present in the case, so as to avoid the benchmark ambiguity problem exposed by the Zhong'anke case.

5.3 Institutional Safeguards: Professional Support for Fault Determination and Mechanisms to Ensure Investor Compensation

The clarification of substantive rules is but one necessary condition for the effective operation of a proportional joint and several liability regime. The judicial survey above demonstrates that judges are heavily reliant on CSRC administrative penalty decisions when determining audit fault, yet the logic of administrative penalties does not correspond to civil fault gradation—administrative penalties do not tell judges whether the fault constitutes "ordinary negligence" or "gross negligence," and judges must independently accomplish the conversion from administrative determination to civil characterization. Bridging this professional gap requires the introduction of external professional expertise into the adjudicative mechanism. In October 2025, the Shanghai Financial Court, in a bond misrepresentation case, pioneered the use of a third-party damage assessment institution to calculate investor losses, setting a precedent for the introduction of external professional institutions to assist in adjudication. In the field of auditing institution liability determination, consideration could be given to having the court commission a third-party institution with audit expertise—such as an expert committee of the Chinese Institute of Certified Public Accountants or an independent audit quality assessment body—to render professional opinions on whether audit procedures comply with standards, the degree of deviation, and the causal nexus between such deviation and the misrepresentation, with the court then making a comprehensive judgment on the basis of such opinions together with the four-dimensional framework described above.

The introduction of proportional joint and several liability may also objectively reduce the amount recoverable by investors from auditing institutions. If the auditing institution remains unable to satisfy its obligation within the proportional range, investor losses will be further unrealized. Following the Kangmei Pharmaceutical judgment, all partners of ZZJ collectively withdrew and the firm's practice license was revoked; of the RMB 57 million in administrative fines and confiscations, only approximately one-tenth was actually paid; the Beijing Financial Court terminated the enforcement proceedings due to the absence of executable assets, exposing this risk. The key to resolving this issue lies in establishing an

effective professional liability insurance mechanism. This article proposes that, for accounting firms engaged in annual report audits of listed companies, a mandatory minimum standard for professional liability insurance be established by departmental regulation, with the insured amount linked to a multiple of the firm's prior-year audit revenue, and the scope of coverage expressly including civil compensation liability arising from audit failure. During the transitional period before the insurance regime is fully established, the Investor Protection Fund could serve a supplementary function: when the auditing institution's proportional compensation remains insufficient to cover investor losses and the issuer is likewise unable to satisfy the obligation, the Investor Protection Fund would compensate the remaining losses within a specified limit—a concept consistent with the advance compensation system established under Article 93 of the Securities Law.

The unification of substantive rules also requires institutional vehicles. The most pressing need is for the Supreme People's Court to clarify, by appropriate means—revising the Provisions on Misrepresentation, issuing a dedicated judicial interpretation, or publishing guiding cases—the following matters: the rule that different liability types apply to the two fault categories of intent and negligence, the principal factors to be considered in determining the proportion, and whether the fault comparison should encompass all responsible parties or be limited to the parties present in the case. The Supreme People's Court announced in February 2026 that it would formulate judicial interpretations on civil compensation for insider trading, market manipulation, and related offenses in the securities market , and this article recommends that the rules governing the determination of proportional joint and several liability of auditing institutions be incorporated into this legislative process [12], or at a minimum that the proportional joint and several liability approach established in the Zhong'anke case be confirmed and refined through the issuance of guiding cases.

6. Conclusion

This article, centering on the determination of proportional joint and several liability of auditing institutions in securities misrepresentation civil compensation cases, has proposed a scheme consisting of: demarcation by subjective state to delineate the application of full versus proportional joint and several liability; a four-dimensional framework to replace vague judicial discretion in proportion determination; and third-party professional institutions and mandatory professional liability insurance as institutional safeguards for the regime's operation. This scheme seeks, within the framework of existing regulations, to provide an operationalizable pathway for filling the regulatory gap between "it is permissible to impose proportional liability" and "in what proportion."

No institutional design, however, is without costs. A potential risk inherent in the proportional joint and several liability framework warrants vigilance: if "intent" corresponds to full joint and several liability while "negligence" corresponds to proportional liability, might auditing institutions develop an incentive toward "deliberate ignorance"—that is, deliberately avoiding in-depth pursuit of anomalous signals during the audit process so as to maintain the characterization of their fault as "negligence" after the fact? This concern has already been raised by scholars in the context of the PSLRA in the United States, and it equally warrants attention in Chinese law. The "only reasonable explanation" standard proposed in this article constrains such strategic behavior to a certain extent—if the anomalous signals were so conspicuous as to be impossible to ignore in good faith, the presumption of intentional acquiescence applies—but whether this standard can operate effectively depends on the courts' capacity for substantive review of audit working papers and audit processes, which circles back to the complementary need for third-party professional assistance in adjudication.

The analysis in this article is built upon a limited case sample—the only landmark case establishing proportional joint and several liability through a final judgment is the Zhong'anke case—and the proposed three-tier classification of negligence and corresponding proportional ranges are derived from an induction of existing adjudicative experience rather than systematic empirical research; their reasonableness awaits validation and refinement through further judicial practice. Moreover, the specific institutional design of mandatory

professional liability insurance and the Investor Protection Fund, being beyond the scope of this article, has not been explored in depth; these issues merit dedicated scholarly attention in the future. The ultimate maturation of rules for determining proportional joint and several liability is more likely to be a process of gradual formation through the ongoing interaction of legislative frameworks, judicial experience, and scholarly consensus, and this article merely offers a stage-specific analytical reference for that process.

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