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PECULIARITY OF THE PRECISE NUMBER EFFECT: EFFICACY OF PRECISE INITIAL OFFERS ON PAWN STARS NEGOTIATIONS

by Michael Conklin*

I. INTRODUCTION

Extensive literature on the anchoring effect demonstrates how powerful it is as a cognitive bias. It has been found to affect outcomes in nearly every setting tested.[1] Anchoring is effective even when the anchor is absurdly disproportionate, when it is the result of a random event, when it is subtle, and when considerable time has passed from exposure to the anchor.[2] The bias is so powerful that it remains even after one is explicitly warned of its effects.[3] A subset of cognitive anchoring is the precise number effect, under which precise numbers (such as 986) have a greater anchoring effect than a round number (such as 1,000).[4]

This research utilizes a dataset of over 1,000 negotiations from the television show Pawn Stars. A first-of-its-kind Python computer program was created to measure the level of precision in the seller's initial offer to determine if it results in better negotiated outcomes. The counterintuitive findings provide valuable insight into the limits of the precise number effect specifically and cognitive anchoring generally. The results of this study have implications for topics such as inconsistencies in negotiation setting and subject matter, buyer–seller experience disparities, buyer–seller power dynamic disparities, subject-matter knowledge variability, nontraditional negotiation mindsets, and gender. Additionally, the difference between analyzing negotiation outcomes in a real-world setting compared to a theoretical survey with no

[1] *See infra* notes 6–35 and accompanying text.
[2] *See infra* notes 22–30 and accompanying text.
[3] *See infra* notes 31–35 and accompanying text.
[4] *See infra* notes 36–60 and accompanying text.

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consequences is discussed. The counterintuitive findings in this study will likely serve as a catalyst for replication with variation in future research into the topic. Furthermore, the novel framework implemented in this study will contribute to the future of both negotiation literature and cognitive bias literature by allowing for more nuanced analysis of the topic.

II. COGNITIVE ANCHORING GENERALLY

The anchoring effect, sometimes referred to as "anchoring and adjustment,"[5] was first researched in a landmark 1974 paper by Nobel Prize-winning psychologists Amos Tversky and Daniel Kahneman.[6] Anchoring is a pervasive behavioral bias whereby the information a person is exposed to acts as a reference point or anchor and disproportionately affects a future decision.[7] This is accomplished by changing the reference point that people use to make judgments.[8] Once an anchor is set, future judgments are then made in relation to the anchor instead of being made from a neutral assessment of the available information.[9] In a negotiation setting, a buyer performs his evaluation largely by anchoring it on the asking price and then adjusting it downward by what he perceives to be an appropriate amount.[10] For example, if the listing price on a house is $450,000, in the mind of the buyer the negotiation is likely to be anchored to how far down from the $450,000 he is able to get the seller to go. If the final negotiated price is $390,000, for example, the buyer is likely to describe the success of the negotiation in terms of how far from the asking price he was

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[5] Gregory B. Northcraft & Margaret A. Neale, *Experts, Amateurs and Real Estate: An Anchoring-and-Adjustment Perspective on Property*, 39 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 84, 84 (1987).
[6] *See* Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974).
[7] Eva M. Krockow, *Outsmart the Anchoring Bias in Three Simple Steps*, PSYCH. TODAY: STRETCHING THEORY (Feb. 11, 2019), https://www.psychologytoday.com/us/blog/stretching-theory/201902/outsmart-the-anchoring-bias-in-three-simple-steps (defining cognitive anchoring as "the automatic processes of identifying available information to provide a focal point or a baseline for our judgement").
[8] *Id.*
[9] Tversky & Kahneman, *supra* note 6, at 1128.
[10] Northcraft & Neale, *supra* note 5, at 85.

able to convince the other side to go, here, $60,000. However, if this same house were listed for $395,000, the buyer is likely to not maintain the same positive perspective on the negotiation, as here he was only able to talk the seller down $5,000. Note that this anchoring effect is a cognitive heuristic, meaning it describes human behavior as it is, regardless of its illogical nature. While a purely rational actor would completely disregard the asking price in assessing whether he received a good deal on a purchase, this is rarely the case in human behavior.

Specific to the realm of negotiations and persuasive rhetoric, it is a well-researched conclusion that higher initial offers result in higher final prices.[11] This principle remains constant in a variety of settings, including used car negotiations,[12] eBay transactions,[13] and plaintiff attorneys' requests for damages.[14] Anchoring can also have a significant effect in non-negotiation settings. Studies have found that anchoring affects estimates regarding the field goal percentage of a basketball player,[15] the height of a bridge,[16] the probability of a nuclear war,[17] the predicted ferocity of an animal,[18] and the mean winter temperature in Antarctica.[19]

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[11] David D. Loschelder, Johannes Stuppi & Roman Trotschel, *"€14,875?!": Precision Boosts the Anchoring Potency of First Offers*, 5 SOC. PSYCH. & PERS. SCI. 491, 491 (2013). ("In negotiations, higher first offers from sellers drive up sale prices—reversely, buyers benefit from lower first offers. Whereas abundant research has replicated this robust anchoring effect of opening offers . . . .").

[12] *Id.* at 491.

[13] *See* Matthew Backus, Tom Blake & Steven Tadelis, *Cheap Talk, Round Numbers, and the Economics of Negotiation* (Nat'l Bureau of Econ. Rsch., Working Paper No. 21285, 2015), https://www.nber.org/papers/w21285.pdf.

[14] Gretchen B. Chapman & Brian H. Bornstein, *The More You Ask for, the More You Get: Anchoring in Personal Injury Verdicts*, 10 APPLIED COGNITIVE PSYCH. 519, 522 (1996). This was a mock jury study in which the plaintiff's attorney either requested $10,000, $75,000, or $150,000 in damages. All other information presented to the jurors remained constant. The average juror awards were $18,000, $62,800, and $101,400, respectively.

[15] Chris Janiszewski & Dan Uy, *Precision of the Anchor Influences the Amount of Adjustment*, 19 PSYCH. SCI. 121, 122 (2008).

[16] Fritz Strack & Thomas Mussweiler, *Explaining the Enigmatic Anchoring Effect: Mechanisms of Selective Accessibility*, 73 J. PERSONALITY & SOC. PSYCH. 437, 440 (1996).

[17] Scott Plous, *Thinking the Unthinkable: The Effects of Anchoring on Likelihood Estimates of Nuclear War*, 19 J. APPLIED SOC. PSYCH. 67, 67 (1989).

[18] Paul M. Herr, Steven J. Sherman & Russell H. Fazio, *On the Consequences of Priming: Assimilation and Contrast Effects*, 19 J. EXPERIMENTAL SOC. PSYCH. 323 (1983).

[19] Strack & Mussweiler, *supra* note 16, at 441.

Cognitive anchoring can even affect non-numerical judgments. A 1999 study found that asking questions that anchored Asian women to their race resulted in significantly better performance on a subsequent math test than if they were asked questions to anchor them to their gender.[20] A 2015 study found that a passerby is more likely to render aid to a stranger when near a hospital, church, or flower shop, likely due to an anchoring effect from the locale.[21]

Cognitive anchoring is so powerful that it affects outcomes even when the anchor is absurdly disproportionate, when it is the result of a random event, when it is subtle, or when considerable time has passed from exposure to the anchor. A 2001 study asked students if they thought their textbook for a class would cost more or less than $7,128.53, followed by a question asking them how much they predicted their textbook would cost.[22] This produced significantly higher estimates compared to a group that was only asked to predict the cost of their textbook without the $7,128.53 anchor.[23] In the Tversky and Kahneman study, one experiment had participants spin a wheel numbered one through 100.[24] Participants were then asked to guess if the number of United Nations countries in Africa was greater than or less than this number.[25] Finally, participants were asked to guess what the actual number of United Nations countries in Africa was.[26] Despite participants knowing that the initial number was random and therefore irrelevant, those whose spin resulted in a higher number had higher guesses as to the actual number of

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[20] Margaret Shig, Todd L. Pittinsky & Nalini Ambady, *Stereotype Susceptibility: Identity Salience and Shifts in Quantitative Performance*, 10 PSYCH. SCI. 80, 80 (1999).
[21] Lubomir Lamy, Jacques Fisher-Lokou & Nicolas Gueguen, *Places for Help: Micro-Level Variation in Helping Behavior Toward a Stranger*, 116 PSYCH. REPS.: RELATIONSHIPS & COMMC'NS 242, 246 (2015). In this research, the authors posit that this is the result of how those locations anchor people to emotions of love and therefore influence them to behave in a loving manner.
[22] Chris Guthrie, Jeffrey J. Rachlinski & Andrew J. Wistrich, *Inside the Judicial Mind*, 86 CORNELL L. REV. 777, 788 (2001) (citing SCOTT PLOUS, THE PSYCHOLOGY OF JUDGMENT AND DECISION MAKING 146 (1993)).
[23] *Id.*
[24] Tversky & Kahneman, *supra* note 6, at 1128.
[25] *Id.*
[26] *Id.*

countries.[27] A 2019 study found that simply mentioning high or low numbers causes people to give abnormally high or low answers to an unrelated question.[28] The mock jurors in the study gave longer prison sentences to a defendant who was caught on Eighty-First Street on March 31 after a forty-five minute wait compared to jurors who heard about a defendant on First Street on March 2 after a three-minute wait.[29] A 2001 study found that the bias persists even when a week has passed since exposure to the anchor.[30]

The near universal applicability of the anchoring effect is made further relevant by its resilience to mitigation efforts. As one expert explains, "it has proved to be almost impossible to reduce . . . ."[31] A 1996 study tested eight anti-anchoring prompts that explicitly warned participants of the anchoring bias, and all were unsuccessful.[32] While non-experts are generally more susceptible to cognitive anchoring,[33] even experts who are making routine judgments in their areas of expertise are not immune.[34] For example, a judge's sentence in a criminal trial is significantly affected by the suggested sentence of the prosecutor.[35]

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[27] *Id.* To simplify the data set, the wheel was rigged to stop at either ten or sixty-five. *Id.* For participants whose wheel stopped at ten, their average estimate as to how many United Nations countries were in Africa was twenty-five. *Id.* For participants whose wheel landed on sixty-five, their average estimate was forty-five. *Id.*

[28] Michael Conklin, *Combating Arbitrary Jurisprudence by Addressing Anchoring Bias*, 97 WASH. U. L. REV. ONLINE 1 (2019).

[29] *Id.* Mock jurors in the former case rendered an average sentence that was 31% higher than those in the latter group. *Id.* at 4.

[30] Thomas Mussweiler, *The Durability of Anchoring Effects*, 31 EUR. J. SOC. PSYCH. 431, 431 (2001).

[31] Thomas Mussweiler, *The Malleability of Anchoring Effects*, 49 EXPERIMENTAL PSYCH. 67, 71 (2002). Another expert describes how anchoring is "virtually immune to corrective attempts." Thomas Mussweiler & Fritz Strack, *The Semantics of Anchoring*, 86 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 234, 235 (2001).

[32] Timothy D. Wilson, Christopher E. Houston, Kathryn M. Etling & Nancy Brekke, *A New Look at Anchoring Effects: Basic Anchoring and Its Antecedents*, 125 J. EXPERIMENTAL PSYCH. 387, 397–98 (1996).

[33] *See generally* Michael J. Seitz, Nikolai W. F. Bode & Gerta Koster, *How Cognitive Heuristics Can Explain Social Interactions in Spatial Movement*, 13 J. ROYAL SOC'Y INTERFACE 1, 1 (2016).

[34] Keith E. Stanovich & Richard F. West, *On the Relative Independence of Thinking Biases and Cognitive Ability*, 94 J. PERSONALITY & SOC. PSYCH. 672 (2008) (finding that cognitive ability is largely not correlated to the ability to successfully avoid biases such as cognitive anchoring); Gretchen B. Chapman & Brian H. Bornstein, *The More You Ask for, the More You Get: Anchoring in Personal Injury Verdicts*, 10 APPLIED COGNITIVE PSYCH. 519, 521 (1996).

[35] Birte Englich & Thomas Mussweiler, *Sentencing Under Uncertainty: Anchoring Effects in the Courtroom*, 31 J. APPLIED SOC. PSYCH. 1535, 1538–41 (2001) (finding that a suggested two-month sentence resulted in an average

III. PRECISE NUMBER EFFECT

Cognitive anchoring in a negotiation setting is not limited to high initial offers resulting in higher final prices. Studies show that the use of precise numbers as opposed to round numbers has a potent anchoring effect that increases the likelihood of a favorable negotiated outcome. This is referred to as the precise number effect or the precision effect.[36] A 2013 study examined how the use of a precise initial offer (such as $1,486), compared to round numbers (such as $1,500), also produces an anchoring effect.[37] The study found that when a precise number is presented as a first offer in a negotiation, the other side is more likely to assume the number is based on some objective standard from subject-matter knowledge compared to when a round number is used.[38] Consequently, the use of precise numerical expressions causes recipients to believe that the number conveys more information as to the true value of the item being negotiated, regardless of whether it actually does.[39] This is because it is human nature to assume that someone would only express information in a manner that is no more precise than his subject-matter knowledge justifies.[40] This belief—that there must be a good, objective reason for a precise number—results in counteroffers that deviate less from the original offer than when round numbers are initially used.[41] In the legal context, a 2021 study found that mock jurors award significantly more in

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sentence of 18.78 months, while a suggested thirty-four-month sentence resulted in an average sentence of 28.7 months).

[36] David D. Loschelder, Malte Friese, Michael Schaerer & Adam D. Galinsky, *The Too-Much-Precision Effect: When and Why Precise Anchors Backfire with Experts*, 27 PSYCH. SCI. 1573 (2016).

[37] Malia F. Mason, Alice J. Lee, Elizabeth A. Wiley & Daniel R. Ames, *Precise Offers Are Potent Anchors: Conciliatory Counteroffers and Attributions of Knowledge in Negotiations*, 49 J. EXPERIMENTAL SOC. PSYCH. 759 (2013).

[38] *Id.* at 762.

[39] *Id.* at 759; *see also* Alexandra Jerez-Fernandez, Ashley N. Angulo & Daniel M. Oppenheimer, *Show Me the Numbers: Precision as a Cue to Others' Confidence*, 25 PSYCH. SCI. 633, 633 (2013).

[40] Mason et. al., *supra* note 37, at 760.

[41] *Id.*

punitive damages when the plaintiff's attorney asks for a precise number rather than a round number.[42]

A 2008 study utilizing five experiments provided a more detailed explanation for the effects of precision in initial offers.[43] The study explained that adjustments away from the anchor point are viewed along a subjective representational scale, much like tick marks on a ruler.[44] The perceived "resolution" of this scale is affected by whether the anchor is a precise or round number.[45] Precise numbers create a more finely tuned scale than round numbers.[46] Therefore, deviations away from an anchor appear to be more severe—move through more tick marks on the imaginary ruler—when a precise anchor is used.[47] For example, an offer of $1,300 for an item listed at $1,500 is likely to be perceived on a scale that utilizes $100 increments. On such a scale, this offer is only two units lower than the listed price. Conversely, if the listing price was $1,490, a $1,300 offer would conjure up a perceived scale with $10 increments. On such a scale, the $1,300 offer would be nineteen units lower than the listing price. In both instances the offer was the same, but because of the perceived scale created by the differences in the listing price, the $1,300 that is in response to the $1,490 listing price is likely to be perceived as more extreme because of the more finely tuned scale used to view it.

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[42] Michael Conklin, *Precise Punishment: Why Precise Punitive Damage Requests Result in Higher Awards than Round Requests*, 10 MICH. BUS. & ENTREPRENEURIAL L. REV. 179, 188–89 (2021). Mock jurors were given identical case summaries, but the plaintiff's attorney either asked for the round number of $500,000 or the specific numbers of either $497,000 or $503,000. *Id.* Average mock jury awards were $359,370, $387,274, and $377,108 respectively. *Id.*

[43] Janiszewski & Uy, *supra* note 15.

[44] *Id.* at 126.

[45] *Id.*

[46] *Id.*

[47] *Id.*

Two other explanations for how the precise number effect works are provided in a 2010 study on real estate pricing. The first explanation involves how precise numbers are more difficult to process than comparable round numbers.[48] This processing difficulty evokes feelings of uncertainty, which induces one to "consider the implication of precision for the magnitude of the price."[49] When research participants were primed to either feel confident about evaluating real estate prices or inadequate, the confident group was less likely to be unjustifiably anchored to precise numbers.[50] The second explanation involves how precise numbers are incorrectly perceived as smaller because people are used to large numbers being rounded off.[51] For example, numbers in the millions are frequently rounded off to the nearest tenth of a million such as $3.7 and $6.2 million. It is rare to see a price in the millions with non-zero numbers in the hundreds place, such as $3,742,500.[52] Therefore, when someone sees a non-zero number in a lower digit of a number—as is the case with precise numbers—they incorrectly associate the number as being lower than it is.[53] This reality that precise prices are perceived as lower than round prices means that when precise pricing is used, the other side in a negotiation is more likely to accept the original offer or, alternatively, more likely to present a counteroffer that deviates less from the initial price.[54]

A 2015 study involving eBay transactions found that sellers who list items in $100 increments receive offers that are 5% to 8% lower than similarly situated sellers who use more

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[48] Manoj Thomas, Daniel H. Simon, & Vrinda Kadiyali, *The Price Precision Effect: evidence from Laboratory and Market Data*, 29 MARKETING SCI. 175, 176 (2010).
[49] *Id.* at 176.
[50] *Id.* at 180.
[51] *Id.* at 179.
[52] *Id.* at 176.
[53] *Id.* at 177.
[54] *Id.* at 184.

precise values.[55] The study posited that round numbers are used as a "cheap-talk tool" by sellers to communicate to buyers that they are willing to reduce the price in order to make a sale.[56] This means that a seller who prefers expediency over maximizing the sale price will list an item for $200 instead of $198.[57] The $198 starting price would eventually lead to a higher sale price, but the $200 listing price will receive offers sooner.[58] In this way, while the use of precise offers is generally a best practice in negotiations, this assumes participants want to maximize or minimize the final price. But as this eBay study illustrates, there could be other considerations at play. Regardless, this study still supports the position that using precise numbers results in counter offers that are less divergent from that offer.

Like anchoring in general, the precise number effect appears to have little in the way of any limiting principle. A 2014 study showed that while moderately precise offers are more effective than round offers, highly precise offers are even more effective than moderately precise offers.[59] There is also strong evidence to suggest that the anchoring effects of using precise numbers is also present in many instances other than traditional buyer–seller negotiations. Studies have found that precise anchors result in higher predictions when compared to round anchors in a variety of categories. These include estimating the amount of protein in a beverage, height of a car, cost of cheese, life of a pen, and field goal percentage of a basketball player.[60]

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[55] Backus et al., *supra* note 13 (noting that for the type of listings used in this study, eBay is less like an auction and more like a face-to-face negotiation in which a seller lists a product for a given price and potential buyers can make lesser best offers that the seller can then choose to accept or provide a counteroffer to).
[56] *Id.* at 2.
[57] *Id.* at 1.
[58] *Id.*
[59] Loschelder, Stuppi & Trotschel, *supra* note 11, at 496 (concluding, consistent with other negotiation studies regarding precise offers, that increased precision in the initial offer likely enhances the perceived credibility and expertise of the person who made it, which in turn increases the potency of the anchoring effect of the initial offer).
[60] Janiszewski & Uy, *supra* note 15, at 122.

IV. METHODOLOGY

This study utilizes a dataset of 1,099 negotiations from the television show Pawn Stars. The structure of the interactions on the show are largely consistent. A seller will come into the pawn shop with an item to sell and explain to the buyer what the item is. The buyer will then ask the seller how much he or she wants for the item.[61] Then, either the negotiation follows or an expert is brought in to provide an assessment of the item's value after which the negotiation follows. The appraiser almost never hears the seller's initial offer before rendering his appraisal. After deleting 44 rare encounters when the seller did not make the first offer, the dataset contained 1,045 negotiations.

There is no universally agreed upon formula for determining when a number is round and when it is precise. Some studies look to the existence of zeros in a number to determine if it is round or not.[62] This is problematic for a variety of reasons. It ignores how some numbers are more precise than others. For example, $631,862 is more precise than $631,800, which is more precise than $631,000, which is more precise than $630,000, which is more precise than $600,000. The overly simplistic method of only considering zeros also ignores differences in roundness between two numbers with the same zeros, such as $500, which is rounder than $600, and $125, which is rounder than $127.[63] Furthermore, even given the problematic binary nature of the determination,

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[61] This is a peculiar course of action on behalf of the buyer, as it is widely recognized that the best practice in a negotiation is to be the first person to make the offer, whether one is the buyer or the seller. This is because by being the first side to mention a price one is able to set the anchor for the negotiation.

[62] *See, e.g.*, Manoj et al., *supra* note 48, at 176 ("More precise prices, those with more ending nonzero digits . . . .").

[63] The reason $500 is rounder than $600 and $125 is rounder than $127 goes back to the subjective representation scale theory of precision explained at *supra* notes 44–47 and accompanying text. For example, $125 likely causes one to think of a scale with $25 increments, where $150 is the next increment up and $100 is the next increment down. Conversely, $127 likely makes one think of a scale in $1 increments, where $128 and $126 are the nearest increments. Therefore, someone who was given the $127 offer would be less likely to counter with $100, as that is twenty-seven increments less than the initial offer. But someone who was given the $125 offer would be more likely to counter with $100, as it is perceived as the nearest increment down.

it does not provide an objective criterion for the determination. It is left unclear what the cutoff point is for a round versus a precise number. For example, one study implemented a "three zeros" approach for determining when a real estate price was precise or not by simply classifying any price ending in three zeros as precise and everything else as not.[64] This demonstrates the problem with such a binary approach, as $1,000,000 and $641,000 are considered equally round, while $199,500 and $172,363 are considered equally precise. An attempt by one study to measure more nuanced differences in precision was to simply count the ending zeros.[65] While this circumvents the binary problem of other methodologies, it is overly broad. For example, this methodology categorizes $500,000 and $700,000 as equally precise, and $325,000 and $312,000 as equally precise.

In order to conduct a more thorough investigation into the effects of precise offers, a more accurate and finely tuned methodology for assessing the precision of a number is necessary. A computer program was created using Python that applied the following rules:

- For every 0 that is not followed by a non-zero number, attribute 2 points.
- For every 5 that is preceded by either a 7 or a 2 and is followed by either nothing or zeros, attribute 1 point.
- For every 5 that is not preceded by any number and is followed by either nothing or zeros, attribute 1 point.
- For every 1 that is not preceded by any number and is followed by only zeros, attribute 1 point.

[64] Manoj et al., *supra* note 48, at 185. This is the "three zeroes" method. *Id.*
[65] *Id.* This is the "number of ending zeroes" method. *Id.*

Then, the Python program divides the total points by how many digits are in the number and the higher the number produced, the more round the number is. This way $1,000,000 is ranked as rounder than $10,000, which is ranked as rounder than $100.[66] And based on this program, $500 is rounder than $600, $125 is rounder than $127, and $1,000 is rounder than $4,000.

When an expert is brought in to assess the value of the item, he or she sometimes provides an assessment in the form of a range. In such an instance, the average of the provided range was recorded. In order to perform a regression analysis to analyze the effects of initial offer precision on the end result of a negotiation, two data points were created. The first data point documented either the last accepted offer between the buyer and seller or the highest buyer offer, whichever is greater, referred to as "highest offer."[67] The second data point divided expert appraisal with highest offer, referred to as "result ratio."[68] A regression analysis was then performed to measure how much of the variation in the result ratio was attributable to the precision used in the initial seller offer. The data set also allowed for analysis of variables such as gender, item size, use of objective standards, and whether an agreement was ultimately made.

V. RESULTS

A simple regression analysis was performed to determine how much of the variation in the result ratio is explained by the changes in the seller's initial offer level of precision. Put differently, the regression analysis measures whether, and to what extent, the use of precision in an initial offer

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[66] Some may posit that $1,000,000 should be considered equally as round as $100. While measuring roundness is admittedly not an exact science, calibrating the Python program to rank $1,000,000 as rounder than $100 is based on the literature on anchoring. This is because $1,000,000 evokes a scale with larger gaps than $100. Put another way, there are more options for non-zero numbers in the $1,000,000 price range than in the $100 price range.

[67] This way, even if the seller did not ultimately accept the buyer's final offer, it could still be used to measure how effective the seller was by how high he or she was able to get the buyer to go in price.

[68] For a detailed explanation as to why this benchmark was utilized to measure the relative seller success in the negotiation, see the Discussion section.

affects the ultimate outcome of the negotiation. The results emphatically demonstrate no relationship between these two variables. The R^2 was only 0.001, meaning that only one-tenth of one percent of the result ratio is explained by the level of precision in the seller's initial offer (see Appendix A). The p-value for this analysis was 0.52. The data were then divided into male and female sellers, and a regression analysis was performed on each group. This produced an R^2 in the male group of 0.0003 and in the female group of 0.049.[69] P-values were 0.79 for the male group and 0.13 for the female group. Finally, a separate analysis was performed by dividing the data based on whether the seller used an objective standard for the initial offer or a subjective one. Here, the R^2 for the subjective group was 0.0008, while the objective group returned an R^2 of 0.05. The p-value for the subjective group was 0.65 and 0.28 for the objective group.

VI. DISCUSSION

The results of this study elicit discussion for both how emphatic they are and how counterintuitive they are. The literature on both anchoring and the precise number effect are nearly universal in demonstrating the persistence of these cognitive biases.[70] Even studies designed to test mitigation strategies to combat the anchoring effect demonstrate that it is so pervasive that even when addressed in advance, only partial mitigation is possible.[71]

Potential explanations for this counterintuitive result include transaction variables, seller–buyer experience disparities, seller–buyer power dynamic disparities, subject-matter knowledge variability, abnormal mindsets given the pawn shop setting, gender, and sample size. Additionally, the difference between analyzing negotiation outcomes in a real-world setting and in a theoretical

[69] Note that the sellers in Pawn Stars are overwhelmingly male and therefore there were only 48 female observations to analyze here.
[70] *See supra* notes 6–35 and accompanying text.
[71] *See supra* notes 31–35 and accompanying text.

survey setting should not be ignored. Most of the studies on anchoring and the precise number effect involve the latter. In a survey setting utilizing a hypothetical negotiation where the research subject experiences none of the consequences of the negotiation, heuristics such as anchoring and the precise number effect are likely to be more influential. This is because someone in a real-life negotiation is more likely to invest more time and effort into the process. This enhanced scrutiny would likely include increased critical thinking regarding the negotiation—a process that has been shown to mitigate the effects of anchoring bias.[72]

While the real-world setting of this research may help explain the unexpected results, there are some studies conducted in real-world settings that found anchoring and the precise number effect to be present. For example, as discussed above, a study of eBay transactions found that when an item is listed for a precise rather than round amount, it sells for 5%-8% higher,[73] and a 2010 analysis of real estate transactions found that houses listed for precise rather than round amounts have higher selling prices on average.[74]

Attempts to quantify negotiation best practices using real-world settings with real-world consequences are difficult when compared to typical survey settings in which participants can be randomly assigned to different groups and aspects of the negotiation can be fine-tuned to measure nuanced aspects of the negotiation process—such as the use of a precise or round initial offer. In the present research, for example, there were multiple variables that could not be controlled. Most prominently, the item being negotiated for was different each time and varied greatly from jewelry to automobiles and from antiques to autographs. And the initial offers from the sellers ranged from

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[72] *See, e.g.*, Thomas Mussweiler, Fritz Strack & Tim Pfeiffer, *Overcoming the Inevitable Anchoring Effect: Considering the Opposite Compensates for Selective Accessibility*, 26 PERSONALITY & SOC. PSYCH. BULL. 1142 (2000).

[73] Backus et al., *supra* note 13.

[74] Manoj et al., *supra* note 48, at 187.

$20 for an antique stovetop toaster to $3,000,000 for a suit worn by George Washington. These negotiations took place over a span of a few years,[75] at different times of the day,[76] with different sellers. These sellers had different motivations for wanting to sell their items and demonstrated differences in tone, demeanor, tactics, and congeniality.

This research considered multiple different methods for measuring the relative success of round versus precise numbers. The binary end result of whether a final agreement was reached was one option. And while most sellers would likely not consider a negotiation that did not reach a final agreement as a success, there is not a perfect correlation between success and whether the two negotiators reached an agreement. Perhaps the agreed-to price was too low and the seller would have been better off walking away. Perhaps the seller walked away from the buyer's final offer despite the offer being very high given the item; here, the negotiation tactics implemented by the seller are to be commended, despite the failure to reach an agreement. Regardless, a regression analysis was performed to determine if there is a correlation between the use of round versus precise initial offers and whether a final agreement was reached. This produced an R^2 of 0.0016 and a p-value of 0.24.

Another option to measure the success of round versus precise initial offers is to compare the ratio between the initial offer and the highest offer. It could be posited that, percentagewise, the smaller the difference between the initial offer and the highest offer, the more advantageous the deal was for the seller. But such an occurrence could also be the result of a seller providing an initial offer that is too low. For example, this benchmark of success would mean that a seller who

[75] While the exact dates of filming are unknown, the airdates of the episodes used for this study span from 2015 to 2021.

[76] *See, e.g.*, Kurt Kleiner, *Lunchtime Leniency: Judges' Rulings Are Harsher When They Are Hungrier*, SCI. AM. (Sept. 1, 2011), https://www.scientificamerican.com/article/lunchtime-leniency/ (finding that judges are significantly more likely to grant a parole request when they are not hungry).

started out at $500 and sold for $400 would be considered to have received a better deal than someone selling the same item for $450 after starting out at $1,000, when the opposite is true. For similar reasons, using the ratio of the buyer's first offer to highest offer would be equally problematic. Regardless, a regression analysis was performed to determine if there is a correlation between the use of round versus precise initial offers and the ratio of initial offer and highest offer. This produced an R^2 of 0.0017 and a p-value of 0.29.

Fortunately, the interactions on Pawn Stars allows for a third option for evaluating the effectiveness of round versus precise initial offers. On Pawn Stars, after the seller makes an initial offer, an expert on the item being sold is brought in to provide an appraisal. This allows for a somewhat objective benchmark from which deviations in the highest offer can be measured.[77] Therefore, this study measures seller success by measuring the percentage difference between the highest offer and the expert's appraisal. The higher this percentage difference is, the better the outcome for the seller is determined to be. While this is not a perfect benchmark for negotiation success, it is the best available in a real-world setting and given the data available.[78]

There are other differences in the setting from the present study that may additionally contribute to the unexpected results. For example, the people negotiating on behalf of the pawn shop in Pawn Stars are highly experienced. Although this does not necessarily mean that they are also skilled negotiators who utilize best practices, their familiarity with the process may result in

[77] Recall that "highest offer" is defined as either the highest accepted offer from either the buyer or seller or the highest rejected offer from the buyer, whichever is higher.

[78] There still remains a number of explanations other than effective negotiation tactics by the seller that could contribute to a higher "last offer"/expert ratio. For example, perhaps the expert gave an unjustifiably low appraisal. Perhaps the buyer had a disposition not to purchase the item due to logistical issues of selling a large item, already possessing a similar item, a bad experience with a similar item, finding something about the seller's appearance or demeanor unpleasant, or even external factors such as the time of day, weather, or even recent performance of a local sports team that affected the buyer's mood. Fortunately, the large sample size utilized in this research helps mitigate the effects of these potential variables.

an enhanced ability to think critically regarding the seller's initial offer. Studies show that familiarity[79] and a critical mindset[80] are both advantageous to mitigating cognitive biases.

The methodology for the main analysis of this study required the exclusion of all transactions when a subject-matter expert appraiser was not called in. This implies that the buyers were not particularly knowledgeable regarding the items they negotiated for in this study—because had they been, they would not have had to seek an appraisal from an expert. While the appraiser did provide the pawn store employee with valuable knowledge regarding the likely value of the item, this is different from becoming a subject-matter expert, which would entail information other than just an estimated value such as price volatility, unique maintenance/storage costs, predicted amount of time until item sells in store, difficulty of notifying potential buyers, significance and risk of damage to item, etc. It is unclear how this difference might contribute to the counterintuitive findings of this research. A 1996 study showed that subject-matter knowledge reduced the anchoring bias.[81] Furthermore, studies have shown that confidence—which would be more likely present in subject-matter experts—does mitigate the anchoring effect.[82] Furthermore, because the

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[79] Yi Zong & Xiaojie Guo, *An Experimental Study on Anchoring Effect of Consumers' Price Judgment Based on Consumers' Experiencing Scenes*, ___ FRONT. PSYCH. ___ (2022) ("Consumers who have purchasing experience or are more familiar with the question to be judged make more rational price estimates, and they rely on their own experience with little information processing, while consumers without background knowledge are more likely to be influenced by information like prices, cognition degrees, emotions, etc. when making purchase decisions."); Mark W. Bennett, *Confronting Cognitive "Anchoring Effect" and "Blind Spot" Biases in Federal Sentencing: A Modest Solution for Reforming a Fundamental Flaw*, 104 J. CRIM. L. & CRIMINOLOGY 489, 509–10 (2014) (This study references two other anchoring studies that found bankruptcy judges [specialists] demonstrated less anchoring bias than magistrate judges [generalists]. However, the difference between these two groups was slight.).

[80] Mussweiler, *supra* note 72.

[81] Wilson et al., *supra* note 32, at 391. However, the question used to measure the anchoring effect in this study is different in a significant way. It simply asked participants to guess how many countries were in the United Nations after being anchored to the large number of 1,930. *Id.* This is very different from the Pawn Star negotiations as there is an objective, correct answer. In the Pawn Stars negotiations, however, even the world's leading expert on the subject matter would only be able to provide an estimate as to what the item would sell for. Additionally, the offers made by the pawn shop employees had to also consider numerous variables, such as price volatility, unique maintenance/storage costs, predicted amount of time until item sells in store, difficulty of notifying potential buyers, significance and risk of damage to item, etc.

[82] *See supra* note 50 and accompanying text.

precise number effect is effective in part because of how it implies the initial offer is grounded in some objective basis,[83] it would not be surprising that this effect would be diminished when applied to a subject-matter expert who is confident regarding the true value of the item.

Another potential explanation for the results of this study is that here the balance of power in the negotiations were generally tilted in favor of the buyer. Because it is a pawn shop setting, it is the seller who comes in and expresses a desire to sell the item. The pawn shop, however, has not expressed any interest in purchasing the item simply by being available to receive offers. Generally, someone who brings an item into a pawn shop has a greater interest in receiving cash than the pawn shop does of receiving an additional item that it hopefully will be able to resell at a later date for a profit. This power imbalance is in contrast to other real-world studies that involve more balanced power dynamics.[84] An extreme power imbalance might result in the powerful side not paying much attention to the initial offer given by the weaker side, based on the reasoning that the initial offer is largely irrelevant given the seller's desperation to sell.

The unique pawn shop setting may also result in abnormal mindsets for the negotiation. The seller and buyer both may be experiencing more sadness than in a traditional negotiation. This is because the decision of the seller to come to a pawn shop may indicate a desperation for immediate money, which is often the result of an emergency. And the buyer is not purchasing the item for his own personal use and pleasure; rather, it is simply a business transaction in furtherance of his employment.[85] But it is unclear how heightened levels of sadness in the parties involved

[83] *See supra* note 39 and accompanying text.

[84] *See supra* notes 50 & 39.

[85] Oftentimes on Pawn Stars the buyer will even explain to the seller the burden he faces in the event a deal is reached, explaining the paperwork, necessary prepping for sale such as framing a poster or sending off a collectible coin to be certified, creating space to display large items, and listing/shipping items online that do not sell in the store.

would function to negate the effects of anchoring, as a 2000 study would predict the opposite. The study found that experiencing sadness during a negotiation may result in an enhanced assimilation toward the anchor and therefore increases the effects of the anchoring bias.[86]

A 2016 study suggests that, especially when dealing with subject-matter experts, providing an objective explanation for a precise offer is beneficial.[87] The data set used for this research also documented whether the seller's initial offer followed the best practice of providing an objective reason for the amount.[88] A seller who simply stated, "I'm asking for $100," would be classified as utilizing a subjective initial offer, while a seller who stated, "I've seen similar ones sell for $120 so I'm asking for $100," would be classified as utilizing an objective initial offer. Separating the data by whether the initial offer was subjective or objective and then performing a regression analysis on each group returned interesting results. The R^2 for the subjective group was 0.0008, while the objective group returned an R^2 of 0.05. The p-value for the subjective group was 0.65 and for the objective group was 0.28. This is an interesting result that evokes different potential explanations. It is important to note that this result is not simply a product of how an objective initial offer increases the probability of a beneficial outcome—although that does appear to be true. Instead, this means that, of the people who used an objective initial offer, the additional use of a more precise initial offer appears to provide an additional benefit compared to the use of a rounder initial offer. It is unclear why precise initial offers would benefit those who use objective initial offers and not those who use subjective initial offers. One could posit that those in the objective group are, on average, more skilled negotiators than those in the subjective group. But

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[86] Galen V. Bodenhausen, Shira Gabriel & Megan Lineberger, 11 PSYCH. SCI. 320, 320 (2000).
[87] Loschelder et al., *supra* note 36, at 1584 ("A competence-boosting rationale [for the initial offer] prevented the backlash otherwise observed among experts when first offers were overly precise.").
[88] Amanda Penn, *Objective Criteria: Keys to Successful Negotiation*, SHORTFORM (Sept. 28, 2019), https://www.shortform.com/blog/objective-criteria-in-negotiation/.

there is no existing research to suggest that the use of precise initial offers would only benefit skilled negotiators and not unskilled negotiators. Perhaps the objective group—which is likely made up of the more skilled negotiators—displayed more confidence in how its members stated their precise initial offers. This could result in the specificity of the offer having more impact, which is consistent with how the precise number effect works by causing the other side to believe there must be some objective reason for the use of a precise initial offer.[89]

Breaking the data down by gender produced no statistically significant results. However, it is interesting to note that the R^2 for the female seller group was significantly higher than the male group (0.049 compared to 0.0003). And the p-value for the female group approached 10% significance at 0.13, while the male group was 0.79. Studies have demonstrated that females appear to be less affected by anchoring bias,[90] but there does not appear to be any studies that measure the effects of anchoring based on the gender of the person providing the anchor. Note that the pawn shop employee is always male in Pawn Stars, and therefore only the gender of the seller could be analyzed.

After the excluded transactions, there were 294 negotiations evaluated in this study. Since this is far less than the over 1,000 negotiations the data set started with, one may be tempted to posit that this study suffers from an insufficient sample size and that a larger sample size would uncover the existence of the precise number effect. While 294 is far less than the over 1,000 total documented negotiations, it is significantly more data points than is generally used for anchoring

[89] Mason et al., *supra* note 37, at 762.

[90] *But see* Andrea Caputo, *Relevant Information, Personality Traits and Anchoring Effect*, 13 INT. J. MGMT. & DECISION MAKING 62, 70–71 (2014) ("A gender effect seems to exist; female subjects seem to be less affected by anchoring bias than male individuals.").

research. Modern published research papers on the anchoring bias have used sample sizes of 42,[91] 50,[92] and even 25.[93] While the presence of a statistical anomaly can never be completely ruled out, the large sample size in this study and the extremely low R^2 of 0.001 mean that this explanation is highly unlikely.

The counterintuitive results of this study should not be interpreted to suggest that specificity in initial offers is harmful. This study only concludes that, in the dataset utilized, there was no correlation between level of precision in the seller's initial offer and beneficial outcomes. Nothing in the study supports the claim that the use of precise numbers in the seller's initial offer produced worse outcomes for the seller. The regression analysis produced a positive X variable coefficient of 0.023, resulting in a positive slope. Therefore, although the results were far from statistically significant, there was a positive correlation, meaning that precise initial offers corresponded to better outcomes more than worse outcomes—although, again, the difference was not significant. Additionally, the results of this one study should not be interpreted to suggest that negotiators should refrain from using precise offers. The vast majority of studies show a significant benefit to the practice.[94]

As with all suggested best practices in negotiations, the potential benefit must be weighed against the cost of implementation. For example, perhaps the most common negotiation advice is to gain information on the other side—motivations for the negotiation, time constraints, best

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[91] Brite Englich, Thomas Mussweiler & Fritz Strack, *Playing Dice with Criminal Sentences: The Influence of Irrelevant Anchors on Experts' Judicial Decision Making*, 32 PERSONALITY & SOC. PSYCH. BULL. 188, 190 (2006).
[92] Nicholas Epley & Thomas Gilvich, *Putting Adjustment Back in the Anchoring and Adjustment Heuristic: Differential Processing of Self-Generated and Experimenter-Provided Anchors*, 12 PSYCH. SCI. 391, 392 (2001).
[93] Duane T. Wegner, Richard E. Petty, Brian T. Detweiler-Bedell & W. Blair G. Jarvis, *Implications of Attitude Change Theories for Numerical Anchoring: Anchor Plausibility and the Limits of Anchor Effectiveness*, 37 J. EXPERIMENTAL SOC. PSYCH. 62, 64 (2001).
[94] *See supra* notes 36–60 and accompanying text.

alternative to a negotiated agreement (BATNA), etc. And while doing so can often result in a more favorable negotiated outcome, this not only takes time and effort to perform but is also a skill that takes time and effort to perfect. The practice of acquiring an attractive BATNA for oneself is also a commonly suggested negotiation tactic. But again, doing so requires time, effort, and possibly experience.

This consideration of the costs and benefits of negotiation best practices illustrates a significant advantage of using precise numbers when compared to other tactics such as information gathering and acquiring an attractive BATNA. Implementing a precise offer tactic is far less burdensome than other negotiation strategies. Also, using a precise offer requires no outside research or preparation and takes no more time during the negotiation. And unlike some other negotiation best practices, it is not a skill that needs to be perfected through years of trial and error—it can be effectively used by a non-skilled negotiator in his or her very next negotiation.[95] Additionally, the use of precise numbers does not appear to be incompatible with other negotiation best practices.

When utilizing precise offers in a negotiation setting between two individuals, caution should be used to not be too precise. Existing literature on anchoring and the precise number effect can be misinterpreted to suggest that, even in a negotiation between two individuals, more precision always increases the probability of a more favorable outcome. For example, a 2013 study found that increasing the precision of the initial price strengthens the anchoring potency.[96] However, this study involved the purchase of an item from an online store.[97] In that context, the

[95] However, the tactic may potentially increase somewhat in effectiveness over time—not through acquiring nuanced skills in its use—but through incrementally increasing confidence in using the tactic over time.
[96] *See supra* note 59.
[97] *Id.*

extremely precise listing prices of €138.63 and €141.37 used in the study are different from a seller walking into a pawn shop and asking for $138.63. This is because consumers are accustomed to businesses listing prices in a highly precise manner. A consumer seeing a €138.67 list price, for example, likely does not think anything is out of the ordinary. Additionally, store listing prices probably benefit from a default assumption that there is a good, objective reason for the price since businesses go to great lengths to analyze what price points will maximize their profit. Individuals engaging in the one-time selling of a used item, however, have much less data available to justify the use of such fine-tuned precision. For this reason, a buyer is more likely to view an individual's $136.63 initial offer for an item as suspect, as a consumer is to view a store's listing price of €138.63 as suspect.

In the example with an individual asking for $136.63, this could function to negate the primary mechanism through which the precise number effect works, namely, causing the other side to believe the offer is based on some objective standard, and thus take it more seriously. Additionally, an overly precise offer from an individual seller might be interpreted as an annoyance by the other side, thus putting him or her in a hostile mindset. A 2016 study helps confirm the dangers of offers that are too specific, especially when dealing with subject-matter experts.[98] The study begins by stating that "past research has suggested a fundamental principle of price precision: The more precise an opening price, the more it anchors counteroffers."[99] The 2016 study concluded that, while increased precision in an opening offer increases the anchoring effect,

[98] Loschelder et al., *supra* note 36.
[99] *Id.* at 1573.

increased precision with subject-matter experts results in an inverted-U-shaped curve where it is effective up to a point at which increased specificity then decreases the anchoring effect.[100]

An additional regression analysis was run on the data in this study to determine if negative outcomes from highly precise numbers helps explain the overall results of no benefit from using precise offers. For this analysis, the most precise offers were excluded, and, therefore, only round versus mildly precise numbers were analyzed.[101] This analysis returned similar results to the primary analysis in this research, thus negating this potential explanation. In this additional regression analysis, the R^2 was 0.0012, and the p-value was 0.55.

Related to the potential danger of providing an offer that is too precise, negotiators should have a good response prepared if asked "How did you come up with that number?" Responses such as "I just made it up," "That's my birthday," or "I heard using precise numbers produces better results" will likely negate any potential benefit and risk alienating the other side. It is not necessary to have an explanation that perfectly explains every number in one's offer, but some explanation should be prepared. Good examples may include "I saw this baseball card sell for $1,200, and this one is in better condition, so that's why I'm asking for $1,780"; "I saw this comic book sell for $600 last year, and since they just announced they are making a movie out of it, it's got to be worth more now—that's why I'm asking for $970"; or even "My spouse told me I couldn't sell it for less than $85."[102]

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[100] *Id.* at 1584–85.

[101] For purposes of this analysis, any initial offer with a number of less than 0.67 from the Python roundness computer program was excluded. This excluded the most precise offers.

[102] Note that this last example, while better than admitting one has no explanation for his precise offer, this is likely not ideal. This is because it does not communicate any advantage to the other side. The other two examples help communicate the true market value of the item. This third example, however, is largely irrelevant in increasing demand from the buyer.

The practice of utilizing a precise initial offer should also be combined with the practice of an extreme initial offer. There is strong evidence to suggest that because of the anchoring effect, extreme initial offers produce better final results. A 2013 study found that when a plaintiff's attorney makes a high request for punitive damages, adding precision to the figure may function to lend plausibility to the high anchor.[103] Therefore, using precise and extreme initial offers may produce a synergistic effect. And again, the ease of implementation for both precise and extreme initial offers also contribute to the case for their use.

VII. IMPORTANCE OF NEGOTIATION EDUCATION

Unfortunately, the topic of negotiation and persuasion is often not covered in higher education, perhaps due to unsubstantiated accusations of being "exploitative and consequently unethical and unhealthy."[104] Attacks against negotiation education are not supported by the evidence. For example, a recent study found that college students who completed a negotiation class are more likely to agree with the statement "The best outcome in bargaining is one that is fair to all parties."[105]

Offering instruction in negotiation as a standalone class, or as integrated into another class such as Legal Environment of Business or Business Communications, provides monumental benefits that more than justify its coverage. The most salient, primary benefit is the ability to obtain

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[103] Loschelder, Stuppi & Trotschel, *supra* note 11, at 492.

[104] Sutherland Miller, *Organizational Negotiations, Values, and the Mental Health Manager*, 9 ADMIN. MENTAL HEALTH 239, 239 (1982). In my upper-division negotiations class, I address this ethical complaint as follows: "Even if you believe every tactic we learn this semester is unethical, you will still benefit greatly from the class because these are the exact tactics that will be used on you throughout your life and we will cover how best to address them." Anthony P. Ammeter & Bart Garner, *The Impact of a Collegiate Course in Bargaining and Negotiation on Students' Perceptions of Their Own and Others' Attitudes and Behaviors: An Exploratory Study*, 4 AM. J. BUS. EDUC. 31, 37 (2011).

[105] Anthony P. Ammeter & Bart Garner, *The Impact of a Collegiate Course in Bargaining and Negotiation on Students' Perceptions of Their Own and Others' Attitudes and Behaviors: An Exploratory Study*, 4 AM. J. BUS. EDUC. 31, 37 (2011).

better negotiated outcomes for major life occurrences such as buying a car, negotiating a salary, and purchasing a home.[106] And the skills learned during negotiation instruction are also applicable to other, less traditional negotiations that involve general persuasion and effective rhetoric. These situations may include convincing a parent to pay for a study abroad program, persuading a coworker to cover a shift, getting a roommate to take out the trash, or talking a significant other into seeing your preferred movie.

Negotiation instruction also provides benefits beyond simply better negotiated outcomes. It helps people become more comfortable with rejection which in turn helps build confidence.[107] It helps people become more comfortable with constructive conflict and more comfortable voicing dissent.[108] Finally, through the practice of trying to understand an opponent's interests—a critical step in an effective negotiation—skills such as empathy are strengthened.[109] While it is true that students can try and learn about negotiation on their own by reading books and watching YouTube videos, the practice is best taught in a face-to-face environment.[110]

Instruction in negotiation has been found to provide additional benefits for female students. It would likely decrease the gender pay gap because gender differences in negotiating for higher

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[106] Even slight improvements to these negotiated outcomes can result in significant changes. For example, if someone making $100,000 a year negotiates a 3% raise every year as opposed to a 2% raise, after thirty years they will be making more than an extra $60,000 per year. And this dramatic difference is not the result of a significant investment of time and money.

[107] Amanda Dodge, *Why Your Students Need Strong Negotiation Skills*, OZOBOT (Oct. 29, 2019), https://ozobot.com/why-your-students-need-strong-negotiation-skills/.

[108] Anthony P. Ammeter & Bart Garner, *The Impact of a Collegiate Course in Bargaining and Negotiation on Students' Perceptions of Their Own and Others' Attitudes and Behaviors: An Exploratory Study*, 4 AM. J. BUS. EDUC. 31, 37 (2011).

[109] Ashley Abramson, *Cultivating Empathy*, 52 AM. PSYCH. ASS'N 44 (2021).

[110] *How Is Teaching Negotiation Beneficial?*, HARV. L. SCH. PROGRAM ON NEGOT., https://www.pon.harvard.edu/tag/teaching-negotiation/ (last visited Jan. 24, 2023) ("Negotiation is best taught in person.").

pay is a significant contributor.[111] Negotiation education would also likely reduce the gender pay gap by giving female workers the confidence to apply for more promotions.[112] The myth that men are superior to women at negotiating is as harmful as it is false. The truth is that after receiving negotiation instruction, the negotiated outcomes of women equals, and sometimes even exceeds, that of men.[113] This points to another benefit from negotiation instruction: the refutation of harmful gender myths, which not only benefits women by giving them confidence but also benefits them by having more future business leaders who understand the truth about their abilities to negotiate.[114] Finally, a 2018 study suggests that negotiation instruction among women results in long-term benefits such as lower drop-out rates and higher attendance.[115]

While every college student could benefit immensely from negotiation training, the art of negotiation has a special place in legal education.[116] Besides universal implications such as negotiating raises and persuading co-workers, negotiation skills are of utmost importance to lawyers and paralegals. For example, less than one percent of all civil cases filed in federal court

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[111] Katie Shonk, *Women and Negotiation: Narrowing the Gender Gap in Negotiation*, HARV. L. SCH. PROGRAM ON NEGOT.: DAILY BLOG (Dec. 20, 2022), https://www.pon.harvard.edu/daily/business-negotiations/women-and-negotiation-narrowing-the-gender-gap/ ("If men ask for and receive slightly higher starting salaries than women, for example, and continue to negotiate more assertively for themselves over the course of their careers, the gender gap can add up to millions of dollars over time.").

[112] Tara Sophia Mohr, *Why Women Don't Apply for Jobs Unless They're 100% Qualified*, HARV. BUS. REV. (Aug. 25, 2014), https://hbr.org/2014/08/why-women-dont-apply-for-jobs-unless-theyre-100-qualified (explaining that, on average, men will apply for a position when they only meet 60% of the qualifications but women will only apply if they meet 100% of the qualifications). Therefore, by building confidence and becoming more comfortable with making bold requests, negotiation instruction would likely help embolden women to apply for more promotions.

[113] Shonk, *supra* note 111.

[114] In other words, instruction on gender and negotiation would result in more business leaders (the people who do the hiring) who understand women are just as capable as men at negotiating.

[115] David Evans, *Want to Keep Girls in School? Teach Them to Negotiate*, WORLD BANK BLOGS (June 4, 2018), https://blogs.worldbank.org/impactevaluations/want-keep-girls-school-teach-them-negotiate.

[116] John Lande, *Negotiation*, INST. FOR ADVANCEMENT AM. LEGAL SYS., https://iaals.du.edu/educating-tomorrows-lawyers/projects/resources/negotiation (last visited Apr. 12, 2023)

> Law schools need to do an especially good job of teaching negotiation; it is a significant part of the work of virtually all practicing lawyers, regardless of whether they handle civil or criminal matters or whether they do litigation or transactional work. Faculty can help students develop professional identities through simulated experiences showing how negotiation fits into legal practice.

reach a verdict.[117] Therefore, lawyers are far more likely to negotiate a settlement than to persuade a judge or jury. This low trial adjudication rate is likely in part due to the rise of alternative dispute resolution, which also requires a firm foundation in negotiations.[118] Practitioners also benefit from negotiation skills when they attempt to persuade clients who may have deeply ingrained false notions about the law. Finally, the study of negotiation and related aspects of persuasion and effective rhetoric help demonstrate the more practical aspects of litigation. Students often leave a Legal Environment of Business class with a basic understanding of how to apply basic legal principles, but little understanding of the more practical aspects such as the high costs—in time, money, and uncertainty—of going to trial and the subjective nature of trial outcomes.[119]

VIII. CONCLUSION

This research provides valuable insight into potential limits of the precise number effect specifically and cognitive anchoring generally. The counterintuitive findings will hopefully serve as a catalyst for future research into the topic, such as the potential differences that may stem from analyzing real-world negotiations with real-world consequences rather than surveys with hypothetical negotiation situations and predictive tasks with no reward for accuracy. Additionally, the novel framework implemented in this study will contribute to the future of both negotiation literature and cognitive bias literature by allowing for more nuanced analysis of the topic.

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[117] Jeffrey Q. Smith & Grant R. MacQueen, *Going, Going, But Not Quite Gone: Trials Continue to Decline in Federal and State Courts. Does it Matter?*, JUDICATURE (2017), https://judicature.duke.edu/articles/going-going-but-not-quite-gone-trials-continue-to-decline-in-federal-and-state-courts-does-it-matter/#:~:text=Today%2C%20approximately%201%20percent%20of,disposition%20rate%20is%20even%20lower

[118] *Alternative Dispute Resolution*, CORNELL L. SCH. LEGAL INFO. INST., https://www.law.cornell.edu/wex/alternative_dispute_resolution (last visited Apr. 12, 2023).

[119] See, e.g., *Michael Conklin, The Alford Plea Turns Fifty: Why It Deserves Another Fifty Years*, 54 Creighton L. Rev. 1, 4 (2020).

> Variables such as the makeup of the jury, officer errors in gathering evidence, jurisdiction where the [incident] occurred, and quality of legal representation all affect legal outcomes. Even factors as trivial as how hungry the judge is, the recent performance of a local sports team, and the weather affect trial outcomes.

It is important to view the results of this study in the context of the wide body of anchoring and precise number effect literature, which largely find positive effects from the use of round offers. Additionally, while the data set used for this study did not produce evidence for a precise number effect, it also did not produce any evidence that using precise numbers is harmful to a negotiation. Furthermore, the use of precise numbers in a negotiation as a best practice becomes even more attractive when compared to other negotiation tactics which require far more time, effort, and skill to implement.

Appendix A

Overall Results

Regression Statistics	
Multiple R	0.037697
R^2	0.001421
Adjusted R Square	-0.002
Standard Error	0.211869
Observations	294

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	0.018653	0.018653	0.415547	0.51967342
Residual	292	13.10738	0.044888		
Total	293	13.12604			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.630724	0.050946	12.38015	1.4E-28	0.53045534	0.730993	0.530455	0.730993
X Variable 1	0.023466	0.036402	0.644629	0.519673	-0.048178	0.09511	-0.04818	0.09511

CORPORATE GOVERNANCE AND THE AUDIT FUNCTION IN JORDAN AND THE UK: A COMPARATIVE PERSPECTIVE

by Bashar Hikmet Malkawi*

I. INTRODUCTION

"*Doing right things and doing them in the right way is the essence of Corporate Governance*"[1].

In our globalized world, competition for capital is intense and only jurisdictions with superior corporate governance will attract the foreign direct investment crucial for economic growth and development. Corporate governance is the system by which companies are directed and controlled"[2] and involves a set of relationships between the company's management, its board, its shareholders and other stakeholders.[3] Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined providing proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate economic efficiency, productivity and growth.[4] Due to global economic weakness and corporate scandals, addressing corporate governance problems has

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[1] H. Pandya, Corporate Governance: Role of auditor and auditing committee, *IPASJ* International Journal of Management, Volume 1, Issue 2, July 2013, p. 1.

[2] Cadbury Committee, 1992, available at http://www.ecgi.org/codes/documents/cadbury.pdf, (Last visited November 1, 2016), p. 13.

[3] In 2004, the OECD identified a group of principles that should be available in the framework of corporate Governance: 1. Supporting transparent and effective markets, respect the rules and regulations, and articulate clearly the responsibilities of the concerned authorities of supervision, regulation and enforcement. 2. Protecting shareholders' rights. 3. Protecting the minority and foreign shareholders, ensuring equitable treatment of all shareholders, and ensuring that all shareholders should've the opportunity to redress effectively any violation of their rights. 4. Recognizing the stakeholders' rights established by mutual agreements or law and fostering effective co-operation between corporations and stakeholders. 5. Ensuring the accuracy and punctuality of the corporations disclosures on its financial situation , ownership, performance and any other substantial matters. 6. Ensuring an efficient strategic guidance of the corporation, enabling the board to effectively monitoring management, and articulate clearly the board's accountability to the shareholders and company. See also OECD, 1999, http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf, page 11 (last visited April 20, 2023).

[4] Y. Patel, A Review on Role of Auditor in Corporate Governance - The Auditor's Perspective, International Journal of Management & Business Studies, Vol. 4, Issue 4, Oct. – Dec. 2014, p. 24.

become recognized as essential in averting and/or mitigating corporate failures.[5] Both "soft-law" voluntary codes of conduct (comply or explain)[6] and non-governmental government organizational recommendations[7] and legislation has been invoked to further governance reforms.[8]

This article focuses on the role of the auditor in ensuring superior corporate governance. Massive corporate accounting scandals at Enron, WorldCom, Olympus, Parmalat, Royal Ahold, and Toshiba have revealed the weakness of risk management and the poorness of the governance structures in the private sector[9] and highlighted the need to evaluate the role of the auditor in corporate governance.[10]

A significant marker of good corporate governance in the private sector is transparent and reliable financial reporting since investment decisions are based on financial statements which must be reliable and trustworthy. Indeed, accurate financial reporting of publicly-traded companies constitutes "the" source of information for a myriad of stakeholders including: company manager; shareholders, government regulators and potential investors. If company financial statements cannot be trusted, investors can be victimized and economic development

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[5] Corporate Governance in the Wake of the Financial Crisis http://unctad.org/en/Docs/diaeed20102_en.pdf (last visited June 3, 2023).

[6] The Cadbury Committee Report of 1992 in the United Kingdom was an important development and focused on the financial parts of Corporate Governance, seeking to consider various stakeholder concerns and avert the need for governmental regulation of markets. See about Cadbury report and the post reports, I. Adelpo, The impact of corporate governance on auditor independence, A study of audit committees in UK listed companies, Thesis, 2010, De Montfort University, UK, p. 50.

[7] The International Corporate Governance Network (ICGN) "*Statement on Global Corporate Governance Principles*" is an example. See http://www.ecgi.org/codes/documents/icgn_principles.pdf

[8] See, e.g., Laws that Govern the Securities Industry, available at https://www.sec.gov/about/laws/soa2002.pdf (last visited May 13, 2023). The 2002 Sarbanes-Oxley Act in the United States, an exception to the general hesitancy on the part of governments to directly legislate.

[9] S. Fearnely & V. Beattie, The reform of the UK's auditor independence framework after Enron collapse: An example of evidence-based policy making, International Journal of Auditing, 2014, p. 117.

[10] See L. Krishnan, The role of auditors in the context of corporate governance, available at https://www.wbiconpro.com/28[1].-Krishna.pdf, (Last visited December 2, 2022), p. 4. See also Editorial Journal of Accounting and Public Policy, http://pages.stern.nyu.edu/~jronen/articles/policy_reforms_jaap.pdf (2002) ("Rather, the solution lies in market mechanisms that eliminate the perverse incentives of gatekeepers, most notably the auditors.")

deterred as capital is unlikely to be invested when fraud is a concern.[11] Multi-billion dollar global corporate accounting scandals prove the crucial importance of company auditing in corporate governance. Indeed, the most profound corporate scandals – Enron, Olympus, Toshiba and WorldCom - were all proximately caused by a lack of proper auditing which is a pillar of corporate governance, the failure of which can have devastating consequences.

Auditing is defined as obtaining and assessing evidence concerning statements pertaining to economic actions and events to make certain the extent to which they correspond with the affirmed criteria, and to communicate the result to the stakeholders. Therefore, auditing covers three consecutive processes: investigation, attestation, and reporting economic actions and events.[12] Based on this definition, the principal duty of the auditors is to provide companies with their audit reports, expressing their professional opinion on the annual accounts prepared by the management of the company. During the audit process, auditors are obliged to perform extensive investigations of complex and high volumes of transactions. Auditors play a significant role in validating financial statements. Hence, the auditors' responsibilities include examining the company's books and records and preparing a comprehensive report summarizing their findings and conclusions regarding the financial standing of companies.[13] In addition, auditors may propose solutions for weaknesses in companies' finance and assist management in increasing production capacity of the companies. They are called the "*shareholders' watchdogs*" in an attempt to characterize their role in

[11] Jordan had its headline-grabbing corporate scandals involving companies and banks. One corporate scandal involved Petra Bank which was Jordan's second bank. Due to poor auditing controls, Petra Bank collapsed and became one of the biggest corporate scandals in Jordan's history. See A Delicate State of Affairs, The Economist (Oct. 4, 2003). Other cases involved four local banks. See Isam Qadamani, White Revolution in Banks, Al-Rai Newspaper (July 2, 2007).

[12] 4Y. Patel, *op. cit.,* p. 24.

[13] Over the years, there have been charges that companies hide information and claims of fraud on the part of auditors. See M. Al-Basheer, The Non-Seriousness of the Regulatory Authorities Prevented Stopping Corruption and Failure of Companies, Al-Rai Newspaper (Apr. 21, 2001).

corporate governance. In performing this role, they foster the trust of the public and boost them to believe that the financial statements and declarations are true and fair.[14]

However, the auditors are not an insurer, the notorious question that they hate to hear whenever company scandals occur is "*Where were the auditors?*". Therefore, they do not guarantee the accuracy of the companies' books and the fairness of the financial statements. They are supposed to act with reasonable caution, skill and care in order to ensure that no mistake was made.[15]

Usually, internal and external auditors conduct the audit process into the company's operations. The internal auditors are employees who are appointed by the management of the company, as part of the internal control system, to carry out audits of daily operations of the company.[16]

The accounting scandals have brought into serious question the independence of external auditors and the role of audit committees. The failures of some companies were attributed to the agency problem where managers have taken actions that served their own interests rather than the interests of stakeholders and shareholders.[17] Audit committee is as sub-committee of the board of directors whose main duties are to review the annual reports and financial statements before they are submitted to the board, safeguard the internal audit, review the reports and statements of the external auditor, and to make a liaison between external auditor, internal auditor, executive management and the board of directors.[18]

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[14] See in this regard A. Psaraki, The protection of auditors against civil liability towards their clients in the United Kingdom: the legal regime with and without liability limitation Agreements, Company Lawyer, 2014, p. 1.
[15] *Id.*
[16] N. Tabără & M. Ungurean, Internal audit and its role in improving corporate governance systems, Annales Universitatis Apulensis Series Oeconomica, 2012, Vol. 14, Issue 1, p. 140.
[17] J. R. Brown, Auditor Independence and the Quality of Information in Financial Disclosures: Evidence for Market Discipline versus Sarbanes-Oxley Proscriptions, American Law and Economics Review, March 2010, Vol. 12, Issue 1, p. 40.
[18] These responsibilities were highlighted by the International Standard on Auditing (ISA 2010), the Institute of Internal Auditors (IIA 2014), Section (C.3.1) of the UK Combined Code, Section (205 a) of the US Sarbanes-Oxley Act, and Chapter (5) Section (2) of the Jordanian Corporate Governance Codes (2009); see in this

The external auditor is well considered in the corporate governance framework. Unlike the internal auditor and audit committee, he/she is appointed by the shareholders. The external auditor might be a firm of auditors or a simple independent person appointed according to the company statutory requirements to investigate its financial statements and express his professional opinion on the truth of such statements in an audit report. OCED (2007) described the external auditors as "auditors of an organization which are not under the control of the organization and may not report to objectives set by the organization".[19]

Due to the substantial role the auditor plays in the company's affairs, the Jordanian legislator enacted several provisions in order to articulate the auditor's rights and duties. The legislator carved out a special section in the Company Legislation No. 22 of 1997 to deal with matters such as election of an auditor, contents of auditor's report, attendance of the general assembly meetings, and prohibitions.

Given the remarkable changes due to globalization in recent years, regional transformations and the intensive competition for foreign direct investment, Jordan's Government has instituted a strategic plan "Jordan 2025" in a bid to raise Jordanian competitiveness and revitalize the economy. To the extent that Jordan seeks to become a center of finance and trade, a stable and reliable legal system is essential. To successfully achieve the goal of becoming a financial center, investors need to have confidence that Jordanian companies will accurately report their results. This in turn calls for an analysis of the current law on auditors in Jordan.

The existence of auditors in the United Kingdom may be traced back to the 1800s, when corporate's ownership became separate from management. Hence, shareholders needed

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regard H. Al-Khaddash, Factors affecting the quality of Auditing: The Case of Jordanian Commercial Banks, International Journal of Business and Social Science Vol. 4 No. 11, September 2013, p. 208.

[19] See James O. Alabede, The Role, Compromise and Problems of the External Auditor in Corporate Governance, Research Journal of Finance and Accounting, Vol 3, No 9, 2012, p. 115.

an independent person or entity to ensure that their money was invested correctly by the management. Nowadays, the Companies Act 2006 (CA 2006) governs issues surrounding auditing.

The goal of this article is to assess the legal regime of the external auditors as provided in the Jordanian Company Legislation of 1997 and its amendments, as shareholder jurisdiction, with the UK Companies Act of 2006, which obliges almost all companies to have their financial statements and annual reports audited.[20] The article provides suggestions for improvement in the current legal regime. The reason the UK Companies Act was selected as the comparator jurisdiction in the article is because the original Jordan company law and its amendments were modeled after the UK Companies Act.[21]

Part II of this article provides an overview of the development and incipient regulations of the external auditors. Part III of the article presents the general perspective of the duties and obligations of external auditors in the context of corporate governance noting various shortcomings and inconsistencies between rights and duties of auditors. We also make suggested proposals for amending the current law. Part IV of the article sheds light on some of the major global financial scandals. In Part V, the article analyzes in detail the specific provisions related to external auditors in Jordan and UK laws.

II. Development and Incipient Regulations of the External Auditors

Auditing the affairs of a commercial entity is not a new concept; for centuries external auditors have met this need. The following subsections describe these developments: the

[20] See in this regard, Ch. Butcher, Auditors, Parliament and the courts: the development and limitation of auditors' liability, Journal of Professional Negligence, June 2008 – Vol. 24, Issue 2, p. 67.

[21] Many laws in Jordan are influenced by English laws. Such Jordanian laws include arbitration. See M.I.M., Aboul-Enein, 'The Development of International Commercial Arbitration Laws in the Arab World', *Arbitration: The International Journal of Arbitration, Mediation and Dispute Management* 65(4) (1999): 314-320, p. 319.

dramatic developments in the Jordanian audit profession over the last 70 years and the substantial developments in the U.K.

A. Development of the External Auditor Profession in Jordan

The auditor profession in Jordan has undergone dramatic growth since the first audit office, George Khader's firm, Saba & Co, opened in 1944.[22] In the ensuing years, the profession has increased in size and sophistication and currently, there are almost 200 audit firms and offices including affiliates of global auditors such as the Big Four.[23] International audit firms, especially those associated with Deloitte Touche Tohmatsu, dominate the market for auditing banks and insurance companies, and have a considerable share of the audit market for other corporations.[24]

The Companies Law 1997 requires all limited liability companies, private shareholding companies, limited partnership companies, general partnership companies (whose capital is 100,000 JD or more)[25], limited partnership in shares companies[26] and publicly traded shareholding companies to prepare annual audited financial reports in accordance with "internationally recognized accounting and auditing principles".[27] Public shareholding companies are monitored and regulated by the Jordanian Securities Commission, which requires the full adoption of the International Financial Reporting Standards. In addition to domestic companies, foreign companies operating in Jordan must have their subsidiaries audited by Jordanian licensed auditors.[28]

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[22] See Ahmed Saadah, The Evolution of the Accounting and Auditing Profession in Jordan, Vol. 29 The Auditing Journal 23-25 (1996).
[23] See Modar A. Abdullatif, The Role of Auditing in Jordan: An Empirical Study Expectations 85 (2003) (unpublished Ph.D dissertation, University of Manchester) (on file with author).
[24] See for more details, Abedel Razaq Al- Farah et al, The Accounting and Auditing Profession in Jordan: Its Origin and Development, Developing Country Studies, Vol.5, No.8, 2015, p. 167.
[25] Art. 24-b of the Company Law 1997.
[26] *Id. a*rt. 87.
[27] *Id. a*rt. 192.
[28] *Id.* art. 243.

Regulation of the audit profession in Jordan is a relatively recent phenomenon; as recently as 1961, audit practice was unorganized and practitioners were not required to satisfy any level of academic knowledge or work experience.[29] Thus, any person was inherently eligible to practice auditing regardless of educational qualification or skill level.

The first audit qualification law was enacted in 1961 and outlined certain conditions that had to be fulfilled by an individual licensed to practice auditing.[30] However, the law did not fully enumerate the duties and rights nor specify prohibited activities for an auditor.[31] In sum, the 1961 law provided lax conditions for practicing auditing.

Given economic development in Jordan in the 1970s and 1980s and the increasing number of publicly traded shareholding companies, a need arose for a more comprehensive and updated audit law, leading to the issuance of the Law of the Audit Profession No. 32 of 1985.[32] The 1985 Law revised the provisions concerning qualifications and required that in order to be licensed, the auditor must possess at least a community college degree in accounting and must pass an exam administered by the Audit Profession Council.[33] The law also empowered the Audit Profession Council to supervise the audit profession. The 1985 Law specifically banned auditors from engaging in ten acts including unethical advertising, disclosure of clients' information, and deliberately giving wrong opinions on financial statements.

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[29] See N.S. Khouri, The Evolution of the Audit Profession in Jordan, *Al-Iqtisadi Al-Urduni* (The Jordanian Economist) 82-83 (1994).

[30] See Law of Practicing the Auditing Profession No. 10 of 1961, (permitted licensing of individuals possessing intermediate school certificates and six years of experience.

[31] See K.A. Abdullah, The Audit Profession in Jordan and Kuwait: A Comparative Analytical Study, 9.2 Dirasat Journal 131-151 (1982).

[32] Law of the Practice of the Auditing Profession No. 32 of 1985, Jordanian Official Gazette No. 3323, p. 870, Amman, Jordan.

[33] The Audit Profession Council is mainly government-dominated and consists of twelve members such as the chairman of the Accounting Bureau, head of the Income Tax Department, and governor of the Central Bank of Jordan. See Khouri, *supra* note 3, at 83. See also M. Al-Basheer, Regulations…Is there Anyone to Respond!!!! Vol. 47 The Auditing Journal 1 (2001).

In 2003, a new law was enacted to streamline the governance of the audit profession.[34] The 2003 law provides for the formation of a supervisory authority, known as the Audit Profession Association, similar to the existing one under the 1985 Law. However, the Audit Profession Association includes both auditors and accountants.[35] The Audit Profession Association monitors the performance of auditors and accountants to ensure their compliance with laws and accounting and auditing standards.[36] The law also substantially revised the level of qualification needed for practicing auditing including a requirement of training.[37] Significantly, the 2003 law obligates certain entities, such as partnerships and corporations, to appoint licensed auditors.[38] The mandatory appointment for these entities will provide additional working opportunities for auditors.

The 2003 law and its implementing regulation classifies licensed auditors into categories.[39] The 2003 law designates category A for the highest qualified auditors i.e. those with the highest academic qualifications and experiences. Auditors in category A can audit any company or establishment while auditors in categories B and C can only audit specified institutions[40]. For example, auditors in categories B and C cannot audit banks, insurance companies, or industrial companies.[41]

The 2003 law and its implementing regulation provide guidelines for promoting auditors to higher categories.[42] The classification of auditors into categories may prove

[34] See Provisional Law on Organizing the Audit Profession No. 73 of 2003, Office Gazette No. 4606 (June 16, 2003).
[35] *Id*. art. 4.
[36] *Id*. art. 8 & 9.
[37] *Id*. art. 22 & 28.
[38] *Id*. art. 30.
[39] *Id*. art. 26.
[40] *Id*. art. 26.
[41] Regulation for Classifying Auditors No. 30 of 1986, Official Gazette No. 3389 (April 16, 1986).
[42] The guidelines include possessing additional university degree, additional experience, or professional qualification. See Provisional Law on Organizing the Audit Profession No. 73 of 2003, *supra* note 6, at art. 26.

irrelevant as the majority of auditors can be classified into category A.[43] Moreover, on average, promotion from category B or C to category A can be accomplished in one year or less.

The representation of auditors is by an association rather than a union. The 1985 Law led to the foundation of the first professional auditing association in Jordan which was called the Jordanian Association of Certified Public Accountants.[44] In contrast to the lack of a union for auditors, unions have worked to improve the professions they represent by defending their rights. For instance, attorneys in Jordan have had a union since the 1950s.[45] As well as for some other professions such as doctors, engineers, professors…The fact that auditors are not represented by a union may, in our opinion, indicate that the government assigns it a low level of importance compared to other professions.

B. Development of the External Auditor Profession in the United Kingdom

The British Joint Stock Companies Act (1844) required the appointment of one or more auditors as a condition of the establishment of a company. Pursuant to the Act, every company should annually appoint, at its general meeting, one or more auditors to audit its financial accounts, and in the case that this appointment was not made, any shareholder could require the Committee of the Privy Council for Trade to appoint one. It was the duty of the appointed auditor to prepare an audit report before the company annual general meeting. A copy of this should also be forwarded to the Joint Stock Companies Registrar.[46]

Under the British Companies Act of 1862, companies were dispensed of the appointment of auditors of their accounts. Consequently, it was not compulsory to provide shareholders or the Companies Registrar with an audit report before or in the company general

[43] Category A requires a minimum of a first university degree in accounting and three years of experience in accounting and auditing. *Id*.
[44] For more details about this Association "JACBA", see Abedel Razaq Al- Farah et al, *op. cit.,* p. 173.
[45] See History of Jordan Bar Union, available at <http://www.jba.org.jo/AboutUs/AboutUs.aspx> (last visited April 12, 2022).
[46] For a brief overview of the history of audit profession's development in UK, see Ch. Butcher, *op. cit*, p. 67.

meeting. By virtue of this Act, shareholders were the auditors of their company. The Companies Act of 1879 provided that only the banking companies had to have their financial accounts audited annually by an auditor. The increase of the number of fraudulent practices involving Companies managements led in 1894 to the appointment by the British Board of Trade of an Advisory Committee, chaired by Lord Davey, which reasoned in favor of obligatory accounts audits. The appointment of auditors became compulsory by virtue of the Companies Act of 1900; shareholders had not any option in this regard, and they had the right to receive before the company annual general meeting the audit report prepared by the company auditor. Nevertheless, companies were not required to deposit their audit reports to the Companies Registrar. The Act of 1900 established the basic framework for the legislative regulation of the Audit profession which has remained till this day.[47]

Commencing in the 1980s important developments in furtherance of "*companies good corporate governance*" became important involving corporate control and the procedures of the risk management.[48] The critical role of the corporate auditor was increasingly accepted as an expert independent party qualified for issuing the appropriate opinion on the true and fair of the company's financial accounts. These developments were given more dynamic impetus by the issuing of the Cadbury Committee (1992) which instituted significant changes in the modern principles of corporate governance. The Report required mainly the inclusion in the annual audit report the extent to which management had succeeded to comply with the good governance principles set out by it. The company's auditor had the responsibility to verify the directors' statements. The modernity of the principals of this Report led to the institution of several aspects of good corporate governance in the Combined Code (1998).[49]

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[47] *Id*., p. 67 & 68.
[48] I. Adelpo, *op. cit.,* p. 47-48.
[49] *Id.*, p. 49-51.

Following the Cadbury Report, several Reports (Greenbury Report 1995, Hampel Report 1998, Turnbull Report 1999, Higgs Report 2003, Smith Report 2003, Tyson Report 2003) were issued. The main goals of these subsequent Reports were strengthening the companies controls and auditing, ensuring the independence of the auditors in performing the audit, and promoting higher standards and procedures of corporate governance[50].

In the aftermath of the Enron collapse[51], the British Financial Reporting Council published in July 2003 a revised version of the original Combined Code (1998) in order to strengthen the independence of the external auditors and to ensure the good procedures of corporate governance. The Companies Act of 2006 provided certain changes to the UK companies auditing compared to the Companies Act of 1985. The new draft of section (503) of the 2006 Act required the statement of the name and signature of the company's external auditor in the audit report. [52] With respect to the general corporate governance issues, the most significant provisions are set out in Sections (172-174) of this Act.[53]

A final revision of the UK Corporate Governance Code was issued recently following a number of meetings and consultations in December 2014 and September 2015. The application of this code started on 17 June 2016, as a reporting period was given to companies and their auditors in order to prepare for the new changes. The new revision came to enhance the corporate auditing and to strengthen the good corporate governance[54].

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[50] *Id.*, p. 52.

[51] Following the financial scandals of Enron and WorldCom, the Sarbanes-Oxley Act was issued in the US. This Act reinforced the practices of good corporate governance , and required management to ensure effective internal and external controls. Under this Act, auditors are required to report to the company audit committee all crucial financial issues.

[52] James O. Alabede, *op. cit.*, p. 115 & 116.

[53] E. Shear et al., Corporate governance in financial institutions, Compliance Officer Bulletin, 2010, available at, http://legalsolutions.thomsonreuters.com/law-products/c/Compliance-Officer-Bulletin-Journal/p/100026313., last visited (December 3, 2022).

[54] G. D. Morris, Corporate governance and audit changes, Company Secretary's Review, June 2016, Vol. 40, Issue 1, p. 2.

With the amendments to the EU Audit Directive in 2014 implemented on 17 June 2016, and its related EU Regulation applied on the same date, member States should not exempt any listed or unlisted corporates from the requirements of the original EU Audit Directive of 2006[55]. By virtue of the above amendments, the appointment of auditors became compulsory for all trade entities[56].

III. GENERAL PERSPECTIVE OF EXTERNAL AUDITOR'S DUTIES IN FURTHERANCE OF SUPERIOR CORPORATE GOVERNANCE

Jordan has instituted a long term plan "Jordan 2025" in a bid to strengthen and modernize the Jordanian economy[57] whose principle goal is to implement the right policies and legal structures to foster "a dynamic private sector that is able to compete internationally".[58] A successful implementation of "Jordan 2025" requires therefore a high level of corporate governance since this is inextricably linked to healthy capital markets, an ability to attract and retain (FDI)[59] and generally superior economic performance.[60] Jordanian FDI has not been robust, "FDI inflows, which remains modest with respect to local investments and as a share of

[55] According to the S. 477 of CA 2006: "*(1) A company that meets the following conditions in respect of a financial year is exempt from the requirements of this Act relating to the audit of accounts for that year. (2) The conditions are (a) that the company qualifies as a small company in relation to that year, (b) that its turnover in that year is not more than £5.6 million, and (c) that its balance sheet total for that year is not more than £2.8 million". The Section 480 of the same Act also states that: "(1) A company is exempt from the requirements of this Act relating to the audit of accounts in respect of a financial year if (a) it has been dormant since its formation, or (b) it has been dormant since the end of the previous financial year…*".

[56] G. D. Morris, *op. cit*., p. 1.

[57] See JORDAN ECONOMIC MONITOR Poverty Reduction and Economic Management Unit MIDDLE EAST AND NORTH AFRICA REGION The World Bank www.worldbank.org.jo The World Bank MAINTAINING STABILITY AND FOSTERING SHARED PROSPERITY AMID REGIONAL TURMOIL.

[58] See Omar Obeidat, Gov't launches 'Jordan 2025' development blueprint, http://www.jordantimes.com/news/local/gov't-launches-jordan-2025'-development-blueprint May 11, 2015.

[59] According to the World Bank the lack of robust FDI is traceable to the weak and inefficient institutional environment. Jordan ranks 71 in the World Economic Forum's 2011/12 Global Competitiveness Report, ahead of Morocco (73) but behind Tunisia (40) and the Gulf economies. The country has fallen from 50th position in 2009 because of deterioration in its institutional environment, government bureaucracy, and financial markets.

[60] Ronald J. Gilson, Transparency, Corporate Governance and Capital Markets (2000) The Latin American Corporate Governance Roundtable, http://www.oecd.org/daf/ca/corporategovernanceprinciples/1921785.pdf.

GDP."[61] Investors are unlikely to pour capital into a nation which does not promote a transparent and reliable financial reporting governance environment. Hence the vital role of a robust external auditing system is important to facilitating Jordan's plans of an improved and modern economy capable of competing in a globalized market. In the same context, the United Kingdom has widely acknowledged the vital role of external auditors in sustaining good corporate governance and strengthening the companies control. As an agent for companies' shareholders, the external auditors have to provide them with an objective check on the system in which the financial statements of the company have been prepared and submitted. In the two subsections below, we present in detail the role and duties of the external auditors in auditing companies' accounts and ensuring that their books are kept in a proper manner.

A. The Jordan Approach

Although the external auditor comes to the company as a contractor under a contract, the auditor assumes a responsibility transcending any employment relationship; an agent for the company's shareholders whose interests he is charged to protect.[62] The relationship between external auditors and shareholders is a classic agent-principal issue.[63] Thus, the external auditor-agent owes duties to the shareholder-principal.

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[61] See JORDAN ECONOMIC MONITOR Poverty Reduction and Economic Management Unit MIDDLE EAST AND NORTH AFRICA REGION The World Bank www.worldbank.org.jo The World Bank MAINTAINING STABILITY AND FOSTERING SHARED PROSPERITY AMID REGIONAL TURMOIL at page 23.

[62] See Company Law No. 22 of 1997, *supra* note 19, at art. 199.

[63] The principal-agent characterization resonates well in corporate law. See Faith Stevelman Kahn, Transparency and Accountability: Rethinking Corporate Fiduciary Law's Relevance to Corporate Disclosure, 34 Ga. L. Rev. 505, 507-18 (2000). Another viewpoint argues that auditors cannot engage in an agency relationship with the shareholders where by definition they become subject to the principal's control. Auditor duties should be conceived in formal rather than relational terms, with fidelity going to the rules, to the texts, and to the system that auditors apply. In other words, an auditor is faithful to Generally Accepted Accounting Principles, the elaborate system of rules and standards that determines accounting treatments. See William W. Bratton, Shareholder Value and Auditor Independence, 53 Duke L.J. 439, 445, 486 (2003). See also Amy Shapiro, Who Pays the Auditor Calls the Tune? Auditing Regulation and Clients' Incentives, 35 Seton Hall L. Rev. 1029, 1033 (2005) (auditors has come to serve two masters- the public and the corporation. The auditor is supposed to play the first role of scrutinizing the corporation's financial statements in order to give a candid assessment of quality. The auditor's actual fee-paying client, however, is the audited corporation who hires the auditor to play the second role, that of certifying information).

The Jordanian Company Law of 1997 enumerates a list of specific duties external auditors are obligated to perform. First, an auditor is responsible for monitoring the company's activities.[64] However, the obligation to "monitor the company's activities" is not specifically defined or illustrated. The obligation should be better defined and examples or guidance provided. As the law currently stands, the responsibility is general and ambiguous since monitoring the activities of the company may include many issues an auditor cannot be reasonably asked to perform such as verifying efficiency in managing the company's affairs. Further, the duty of an external auditor to monitor the activities of the company is not backed by any auditing standard.[65]

Second, an external auditor is required to audit the company's accounts pursuant to recognized auditing, scientific, and technical standards.[66] As for standards of auditing and accounting, the 1997 Company Law provided a relatively better definition compared to the previous company law of 1989.[67] The 1997 Company Law states that those standards are the accounting and auditing principles agreed upon internationally and required in Jordan by the designated professional parties. Notwithstanding this improvement, the 1997 Company Law does not define these designated professional parties mentioned in the law.[68]

An external auditor is also required to examine a company's internal financial controls to ensure their suitability with regard to the company's business and safeguard its assets.[69] Although the term "examining internal financial controls" is to some extent general and

[64] See Company Law No. 22 of 1997, *supra* note 19, at art. 193.a. The duty to monitor the company' activities was added in the Company Law of 1997. This duty was included in the 1989 Company Law as a general guideline, but in the 1997 Company aw Law it is included in the list of duties.
[65] See Ali A. Thnibat, Analytical Critical Study of the Consistency of the Auditors' Duties and Responsibilities Mentioned by the Jordanian Acts with those of the International Auditing Standards, 31.1 Dirasat Journal: Administrative Sciences Series 10, 14 (2004).
[66] See Company Law No. 22 of 1997, *supra* note 19, at art.193.b.
[67] The Company Law of 1989 did not specify what was considered as generally accepted accounting and auditing standards. The Company Law of 1989 used the term in a vague form given that there were no such generally accepted standards applied in Jordan.
[68] Arguably, professional parties include the Audit Profession Association.
[69] *Id*. art. 193.c.

undefined, it is a common responsibility of external auditors and conforms to International Standards on Auditing.[70] Among other duties, the external auditor is mandated to verify the company's assets, its ownership, and ascertain the legality and correctness of the company's obligations.[71] This duty is considered a vital responsibility that can be used to gauge the status of the company and ascertain the ultimate ownership/control of the company and its true market value. However, the 1997 Company Law is short on details regarding the external auditor's duty to verify the company's assets.

The 1997 Company Law expanded the power of the company's external auditor to encompass reviewing management affairs and is required to examine decisions of the board of directors and the general meeting of shareholders.[72] For example, an external auditor could examine a decision to purchase or sell to ensure that such financial transactions are done in a legal manner. The list of external auditor's duties ends in a "catch-all" phrase. The external auditor may perform any other duties as required by other laws.[73] The "catch-all" phrase empowers the respective regulatory body to expand duties of an external auditor as it sees fit. Providing examples of expected external auditor oversight would improve this aspect of the 1997 Company Law.

Although article (193) of the 1997 Company Law is supposed to list all duties of an auditor, articles (202, 203) provide for additional duties. Taken together, these articles form the "do's and don'ts" rules for auditors. In other words, the list of duties included in article (193) is drafted in a positive form. For example, auditors are responsible for monitoring a company's performance, auditing its accounts, ensuring that its books are kept in a proper manner. On the

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[70] See Thomas C. Pearson, Creating Accountability: Increased Legal Status of Accounting and Auditing Authorities in the Global Capital Markets, 31 N.C.J. Int'l L. & Com. Reg. 65, 74-78 (2005).
[71] See Company Law No. 22 of 1997, *supra* note 19, at art. 193.d.
[72] *Id*. art. 193.e.
[73] *Id*. art. 193.f.

other hand, articles (202, 203) are drafted in the negative. For example, external auditors are prohibited from disclosing information or speculating on a client's shares.

In addition, the external auditor owes a duty of confidentiality and is thus prohibited from disclosing to shareholders and others any information that comes to his knowledge in the course of exercising his work.[74] However, the duty of confidentiality does not apply when an auditor discovers fraud or any other violation of the laws.[75] In the latter case, the external auditor shall disclose these violations and report them to the appropriate authorities represented by the Jordanian Securities Commission and the Companies' Controller[76]. In sum, the duty of confidentiality is not absolute but rather is inapplicable when the duty conflicts with the interest of shareholders and others in obtaining crucial information.

Other new responsibilities of external auditors under the 1997 Company Law include a prohibition on speculation.[77] This duty is to be added to the previous one of confidentiality. Due to the nature of his work, an external auditor knows the nuts and bolts of the company and has invaluable inside information as to the business. He can easily speculate and profit on the company's shares to gain a profit based upon this knowledge. Thus, to avoid speculation, the 1997 Company Law expressly prohibits an auditor from speculating on a client's shares or otherwise profiting from insider knowledge.[78] However, interestingly the 1997 Company Law limits the scope of the prohibition to trading in company shares only.[79] Indeed, the Company Law does not extend the prohibition to include subsidiary companies. Thus, the external auditor could potentially profit from the inside information via debt trading, or even trading shares of company subsidiaries or rival companies based upon this knowledge. Therefore, the

[74] *Id*. art. 202.
[75] *Id*. Art. 200 & 202.
[76] *Id*. art. 200.
[77] *Id*. art. 203.
[78] *Id.* art. 197 & 203.
[79] *Id*. art. 203

law should be amended to include a comprehensive prohibition of making transactions in the financial markets based upon information learned during the auditor engagement.[80]

A new feature of the 1997 Company Law is that an external auditor, if unable to perform his or her duties, is to withdraw from the audit engagement and disclose the withdrawal both to the board of directors and the Company's Controller.[81] The Company's Controller is charged with discussing the disengagement with the board of directors and, if unable to solve the problems, can disclose that to a general meeting of shareholders if deemed necessary.[82] The law should be amended to mandate public disclosure by the company to alert shareholders and other stakeholders of the external auditor withdrawal.

B. The UK Approach

The Cadbury committee declared in its report of 1992 that

> the annual audit is one of the cornerstone of corporate governance. The audit provides an external and objective check on the way in which the financial statements have been prepared and presented. "[83]

According to the International Standards on Auditing issued by the International Auditing and Assurance Standards Board (IAASB), the external audit must boost the confidence degree of all users in the financial statements, by stating an opinion *"on whether the financial statements are prepared, in all material respects, in accordance with an*

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[80] Debentures are long-term debt notes issued pursuant to a trust indenture. The contract under which debentures are generally issued is called the trust indenture. The trust indenture is entered into between a trustee and the issuing corporation. The trust indenture specifies the rights and obligations of the debenture holders and the issuing corporation and usually delineates the terms of the securities. The indenture trustee has the responsibility of safeguarding the interests of the debenture holders. See Nancy T. Oliver, Fiduciary Obligations to Holders of Convertible Debentures, 58 U. Cin. L. Rev. 751, 754 (1989).

[81] The report of the auditor must include the reasons or circumstances hindering the auditor's work. See Company Law No. 22 of 1997, *supra* note 19, at art. 194.

[82] *Id.*

[83] Cadbury Report, *op. cit.,* p.36.

applicable financial reporting framework... and financial statements give a true and fair view in accordance with the framework".[84]

Through the role of the external auditors, shareholders can monitor the company financial accounts and statements; this role leads to enhance the company's transparency. Auditor obligations are detailed in the sections (495-498) of the Companies Act of 2006[85] the central one being to file an annual comprehensive report[86] on all company financial accounts and presented to the shareholders. Specifically, this report must:

i. identify the annual financial accounts that are the subject of the audit and the financial reporting framework that has been used in their preparation.[87]

ii. describe the scope of the audit identifying the auditing standards used in conducting the audit.[88]

Moreover, the external auditor must state clearly in the annual report whether the annual accounts give a true and fair view pertaining to:

i. in the case of an individual balance sheet, of the state of affairs of the company as at the end of the accounting year.[89]

ii. in the case of an individual profit and loss account and other comprehensive income, of the profit or loss of the company for the accounting year,[90]

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[84] The IAASB is one of the standards-setting of International Federation of Accountants (IFAC). Its main objectives are developing auditing and assurance standards, other pronouncements, and guidance for use by professional accountants (www.ifac.org/iaasb/).
[85] See in the same content, the general duties of the local auditors stated in the Local Audit and Accountability Act of 2014, SS. 20&21.
[86] Companies Act of 2006 section 495.
[87] *Id*.
[88] *Id*.
[89] *Id*.
[90] *Id.*

iii. in the case of group accounts, of the information in the consolidated statement of financial position as at the end of the financial year and consolidated statement of profit or loss and other comprehensive income and consolidated income statement relating to state of affairs as at the end of the financial year.[91]

Likewise, the auditor must state in his report whether in his opinion that the financial statements:

a. have been properly prepared in accordance with the relevant financial reporting framework, and

b. have been prepared in line with requirements of Companies Act of 2006 and IAS Regulations.

Furthermore, the external auditor must indicate the type of opinion provided in the company audit report whether it is qualified or an unqualified opinion, and must place emphasis on matters to which he wishes to draw attention of the shareholders.

Under the section (496) of 2006 Act, the external auditor must state in his audit report on the company's annual accounts whether, in his opinion, the information stated in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts. For the quoted companies, the auditor must report to the shareholders and state on the auditable part of the directors' remuneration report whether it has been properly prepared in accordance with the 2006 Act.

In preparing his audit report, the below duties should be carried out by the external auditor[92]:

i. he must investigate:

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[91] *Id*.
[92] S. 498 of CA 2006.

a. whether adequate accounting records have been maintained by the company and returns adequate for their audit have been received from the company's branches not visited by him.

b. whether the individual accounts of the company are in line with the accounting records and returns.

c. in the case of a listed company, whether the auditable parts of the directors' remuneration report are in agreement with the accounting records and returns.

ii. the auditor must state in his audit report if he is of the opinion that:

a) adequate accounting records have not been kept by the company, or that returns adequate for the purpose of his audit have not been received from the company's branches not visited by him.

b) company's individual accounts are not in line with accounting records and returns.

c) in case of the listed companies, the auditable parts of the directors' remuneration report are not in line with the accounting records and returns.

iii. the auditor must state in his report if he fails to get any information that he considers important for the success of the conduct of his audit[93].

iv. the auditor must state also in his report whether the provisions of the section (412) of the 2006 Act pertaining to the disclosure of the directors benefits are not complied with in the annual accounts of the company. With respect to the listed companies, he must indicate where the provisions of section (421) of the above Act relating to the information on the auditable parts of the directors' remuneration report are not complied with in the report[94].

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[93] See also Section 22 of the Local Audit and Accountability Act of 2014.

[94] According to the Section 499 of CA 2006 *"(1) An auditor of a company (a) has a right of access at all times to the company's books, accounts…(2) (b) may require any of … persons to provide him with such information or explanations as he thinks necessary for the performance of his duties as auditor". He is also entitled under Section 502 : " (a) to receive all notices of, and other communications relating to, any general meeting which a member of*

v. finally, the auditor must state his name and signature on the audit report[95].

Thus, the provisions of the above sections illustrates clearly that vast power are conferred to the external auditors to detect and report any operational or financial management misconduct[96]. This power should be exercised in the best interest of company's stakeholders, and the auditor needs to be independents of the management in carrying out their statutory audit role. However, evidence proved in many cases that auditors have compromised their independence in favor of their economic benefits. In the case of Enron, the auditor, Arthur Andersen relied upon Enron for a significant portion of its income[97] likely jeopardizing its independence.

One of the controversial issues that surrounds the function of companies' external auditors is the gap between their assumed audit role and the expectation of the public. The company shareholders and stakeholders expect that the primary role of auditors is the detection of all kind of material frauds, while the auditors claim constantly that the fraud detection is incidental and not their main role[98].

Another issue surrounding the role of external auditors is the company internal control system which should facilitate their role by ensuring that company maintains quality financial reporting. Nevertheless, if the external auditor observes that the internal control is weak and not reliable, the auditor should do more substantive checks in the external audit[99] and inform management about this weakness that will make his role more difficulty. The weakness in the

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the company is entitled to receive, (b) to attend any general meeting of the company, and (c) to be heard at any general meeting which he attends on any part of the business of the meeting which concerns him as auditor.".

[95] S. 503 CA 2006.

[96] B. Hannigan, Company Law, 2nd edition, 2009, Oxford University Press, p. 393.

[97] D. Marent, Audit Within the Corporate Governance Paradigm: a Cornerstone Built on Shifting Sand?, project of research, Universities of Exeter & Wales, 2006, available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.321.5903&rep=rep1&type=pdf, p. 9, (Last visited January 17, 2023)

[98] James O. Alabede, *op. cit.*, p. 117.

[99] *Id.*

internal control system was illustrated in the Baring Bank case in which the general manager of the bank's Singapore branch was involved in unapproved trading on the Nikkei, which caused in 1995 the loss of hundreds of millions of GBP without informing the head office management in London.[100]

IV. MAJOR GLOBAL FINANCIAL SCANDALS

Corporate financial accounting scandals are one of the most important reasons for international corporate governance reforms focusing on preventing accounting fraud.[101] When accounting scandals surface, the proximate cause is almost always linked to a failed or inferior external audit. This is particularly evident when a company collapses months after an external audit – raising legitimate questions whether the company's external auditor performed its duties correctly[102].

The dramatic collapse of the giant American energy company Enron is an instructive example which shocked the audit profession worldwide. Enron had been touted as a "must-own" stock and at its peak was America's seventh largest company. However, in reality, the company was in bad financial shape, kept afloat by a massive and skillful "smoke and mirrors" accounting charade.[103] Inevitably, Enron collapsed causing immense damage to the U.S. economy and to the credibility of financial reporting.

> Once the nation's seventh-largest company, Enron plunged into bankruptcy proceedings after years of accounting tricks could no longer hide billions in debt or make failing

[100] *Id.*
[101] See Joel Slawotsky, Duke Journal of Comparative and International Law, ("Avoiding massive corporate fraud is not merely one nation's interest, but rather a crucial foundation underpinning the international economic structure.")
[102] L. Krishnan, The role of auditors in the context of corporate governance, available at https://www.wbiconpro.com/28[1].-Krishna.pdf, (Last visited December 13, 2022), p. 4.
[103] See Joel Slawotsky, Duke Journal of Comparative and Int'l Law (2006) at 145 ("Fortune listed Enron as one of "10 Stocks to Last the Decade" and praised Enron "as America's most innovative firm for five years running. In 1999, CFO Magazine named Enron's Chief Financial Officer (CFO), Andrew Fastow, "CFO of the Year."").

> ventures appear profitable. The collapse wiped out thousands of jobs, more than $60 billion in market value and more than $2 billion in pension plans.[104]

Confidence in Enron's auditor Arthur Andersen vanished with serious questions raised with respect to the auditor's independence, quality and potential conflicts of interest as Andersen was paid by Enron in 2001 a sum of $55 million for non-audit services in addition to its audit work.[105] Anderson failed to disclose the accounting fraud enabling management to be enriched with salaries and bonuses of over $150 million although the company was nearing bankruptcy. It became clear that that Anderson firm had failed to perform its audit responsibilities which might have caused Anderson's retention and the reason behind its appointment for many years[106].

Post-Enron, the UK government initiated a precaution series of reviews in collaboration with the Coordinating Group on Audit and Accounting Issues (CGAA) and the Department of Trade and Industry (DTI) to examine whether changes to UK audit regulation and corporate governance were required[107]. The CGAA issued its final report in January 2003 in which it identified 27 recommendations and conclusions that aimed at improving corporate governance, auditor independence, audit firm transparency and strengthening the enforcing of accounting standards[108]. The principal recommendations of the DTI team supported the recognition of professional supervisory bodies and that the independent regulator must have impeccable arrangements for accountability and transparency. The government welcomed these proposals

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[104] http://www.businessinsider.com/10-years-later-what-happened-to-the-former-employees-of-enron-2011-12
[105] D. Marent, *op. cit.,* p. 9.
[106] For more details about Enron Scandal, see L. Krishnan, *op. cit.*, p. 4-5; *I. P. Dewing*, Post-Enron developments in UK audit and corporate governance regulation, Journal of Financial Regulation & Compliance, November 2003, Vol. 11, Issue 4, p. 309.
[107] *Id.,* p. 312.
[108] S. Fearnely & V. Beattie, *op. cit.*, p. 117.

and asked DTI to chair a steering group for developing the framework of the audit regulation[109].

Another example of auditor failure and subsequent economic carnage is the collapse of Lehman Brothers Holding Inc. ("LBHI"), at the time the fourth largest investment bank in the world. In 2008 LBHI filed a petition for bankruptcy[110]; the largest bankruptcy in history, as LBHI had assets of 639 billion USD and debts of 619 billion USD[111]. To illustrate its downfall and losses to investors, in January 2008 the stock price was $62.19, but lost almost 95% of its market value by bankruptcy to $3.65.[112]

But the failure had much more devastating effects in the United States – and globally – ushering in the "2008 financial crisis" and ensuing global economic turmoil. LBHI's failure led to a $10 trillion loss in the global market equity markets. The US Bankruptcy Court appointed examiner, Anton Valukas, was responsible for investigating any facts "*pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity*" in LBHI management. After an intensive investigation involving the review of millions of documents, witness interviews, forensic accounting and evidence from cooperation with the U.S Govt.[113] The examiner issued his report in 2010 reviewing the conduct of LBHI audit firm Ernest &Young (E&Y). After examining this report and the claims raised by the examiner, the US bankruptcy court provided on 27 July 2011 certain arguments on potential liability of E&Y in the collapse LBHI.[114]

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[109] I. P. Dewing, *op. cit*., p. 311-312.
[110] For a detailed study on Lehman scandal, see L. Ball, the fed and Lehman Brothers, Johns Hopkins University, July 2016, available at http://www.econ2.jhu.edu/People/Ball/Lehman.pdf, (Last visited January 30, 2022).
[111] J. Burke, *op. cit*., p. 146.
[112] *Id.*
[113] Report of Anton R. Valukas, *op. cit.,* (VR), Examiner in In re Lehman Brothers Holding Inc., Chapter 11 Case No. *08-13555,* United States Bankruptcy Court for the Southern District of New York, vol. 1, at 29, *available at* https://jenner.com/lehman, (Last visited February 22, 2023).
[114] J. Burke, *op. cit*., p. 147.

LBHI used in its transactions "Repo *105"* and "Repo *108*" in order to reduce net leverage ratios in its periodic declared reports. These devices permitted to LBHI to reduce by whole numbers its net leverage ratio, which reflected a false picture of the financial position of LBHI in repaying its debts from its assets. The false picture also led to a large illusion of liquidity in the balance sheet. LBHI had failed to disclose in its periodic and annual financial reports the illusions until it reported in the second quarter of 2008 a loss of 2.8 billion USD and 3.9 billion in the third quarter. [115]

LBHI used also a mechanism called SFAS 140 to mischaracterize secured borrowing as a sale of assets that enabled it to conduct an off-balance sheet transaction in order to lower its Net Leverage Ratio: "*A transfer of financial assets in which the transferor surrenders control over those assets is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange*."[116] LBHI used the cash received from the loan for paying down short-term borrowings. In other words, LBHI borrowed multiple billions without revealing this information to the public. Thus, when LBHI executed a large ($50 billion Repo *105*) transactions, the transaction was described as a sale and, subsequently, this sum would be removed from the balance sheet[117] enabling LBHI to declare unchanged assets and receive $50 billion. This example was directly illustrated by the examiner who demonstrated in his report that "*Lehman records no liability to return the cash borrowing so likewise liabilities remain unchanged thereby leverage is unaffected*"[118].

As a result of these followed fraudulent mechanisms, the management's misguided decisions, and the misleading statements the financial position of LBHI was extremely

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[115] *Id*., p. 150.
[116] Financial Accounting Standards Board, Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* (September 2000) *available at* http://www.fasb.org/summary/stsuml40.shtml.
[117] Report of Anton R. Valukas, *op. cit.*, vol. 3, at 758, illus. 4.
[118] *Id.*

precarious during 2007-2008. Therefore, to meet the shareholder expectations and continue the charade, LBHI's Management increased the number and volume of transactions (Repo *105* and Repo *108*), without considering the true dire financial position.[119] The examiner concluded that many evidences supported that the failure of LBHI to disclose the reliance upon Repo *105* transactions to reduce its net leverage ratio and net balance sheet was significantly misleading. Furthermore, the examiner concluded that LBHI's financial statements, which generated by reliance upon this Repo and treating the borrow transactions as true sales, were materially misleading and affirmatively misrepresented. Based on these evidences and facts, the examiner found that LBHI's management breached its fiduciary duties[120].

Significantly, the Examiner found sufficient evidence that supported claims against LBHI's external auditors (E&Y) for professional negligence arising from their failure to take professional care regarding communications with LBHI's Audit Committee, investigation of whistleblowers claims, and auditing LBHI's public filings. According to the Generally Accepted Auditing Principles a primary responsibility of external auditors is to provide their opinions whether the firm's financial statements are presented, in all material respects, truly and fairly in accordance with these principles. Moreover, the examiner concluded that E&Y had ignored the standards and rules stipulated in the Sarbanes-Oxley Act (2002) and the Public Accounting Oversight Board established by this Act.[121]

The examiner concluded that "*sufficient evidence exists to support at least three colorable claims that could be asserted against Ernst & Young relating to Lehman's Repo 105 activities and reporting: (1) negligence in connection with the investigation into whistleblower Matthew Lee's claims concerning $50 billion in Repo 105 activities at the end of the second*

[119] *Id.,* Vol. 3, at 850, 853 & 856.
[120] Report of Anton R. Valukas, *op. cit.,* Vol. 3, at 963.
[121] Report of Anton R. Valukas, *op. cit.,* Vol. 3, at 1028.

quarter 2008, including failing to conduct an adequate inquiry into the allegations prior to the filing of Lehman's Form 10Q, and failing to properly inform management and the Audit Committee of Lee's allegations; (2) at least with respect to Lehman's first quarter and second quarter 2008 Forms 10Q, if not with respect to earlier filings, negligence by failing to take proper action when Ernst &Young was made aware that the financial information may be materially misleading because of the failure to disclose the effect of the timing and volume of Lehman's Repo l05 activities (which had a material effect on interim financial statement items), and failing to take proper action with respect to materially misleading statements contained in the MD&A sections of the Forms 1OQ for these quarters; and (3) at least with respect to Lehman's 2007 Form 10K, if not with respect to earlier Forms 10K, negligence by failing to take proper action when Ernst & Young was made aware that the financial statements may be materially misleading because of the failure to disclose the effect of the timing and volume of Lehman's Repo 105 activities (which had a material effect on financial statement items), and failing to take proper action with respect to materially misleading statements contained in the MD&A sections of the Form 10K"[122].

Another example of accounting fraud was the collapse of the US communications giant WorldCom in 2002. WorldCom's debt had reached $28 billion USD while at the same time, a senior manager received a loan from the company of $366 million[123]. The company's auditor, who was also Arthur Andersen, did not reveal the irregularities in the company's accounts. Unfortunately, the auditor compromised its independence[124] in favor of the economic benefits earned from the performance of non-audit services[125].

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[122] Report of Anton R. Valukas, *op. cit.,* Vol. 3, at 315-316.
[123] For more details about this case, see D. Marent, *op. cit*., p. 13.
[124] Once again Anderson's conflicts of interest may have compromised objectivity and independence directly causing the collapse of the Australian insurer HIH in 2001 in 2001 caused losses of 5.3 billion AUSD For more details about this case, see L. Krishnan, The role of auditors in the context of corporate governance, available at https://www.wbiconpro.com/28[1].-Krishna.pdf, (Last visited February 22, 2022), p. 5.
[125] J. Alabede, *op. cit.*, p. 119

Xerox's accounting practices in 1999 and 2000 were the subject of a general investigation by the US SEC[126]. The main allegation against the company's auditors KPMG was: "*From at least 1997 through publication of the company's 2000 financial report, Xerox abandoned its obligation to accurately report its financial condition. Instead, the company defrauded its shareholders and the investing public by overstating its true equipment revenues by at least $3 billion and its true earnings by approximately $1.5 billion during the four-year period*"[127]. To did so, Xerox used undisclosed manipulative accountings devices before the end of each accounting reporting period that distorted the real figures of its business performance.

The actions of the defendant KPMG were characterized by the SEC as the following: "*Although the defendants occasionally voiced concern to Xerox management about the "topside accounting devices" developed and manipulated by senior corporate financial managers to increase revenue and earnings, the defendants did little or nothing when Xerox ignored their concerns and continued manipulating its financial results. The defendants then knowingly or recklessly set aside their reservations, failed in their professional duties as auditors, and gave a clean bill of health to Xerox's financial statements. Rather than put at risk a lucrative financial relationship with a premier client, the defendants failed to challenge Xerox's improper accounting actions and make the company accurately report its financial results*".[128]

In another example, Tyco's CEO and other senior managers[129] obtained enormous and undisclosed loans from Tyco.[130] During the years 1996 – 2002, the managers obtained, in

[126] D. Marent, *op. cit*., p. 18.
[127] Available at http://www.sec.gov/litigation/complaints/comp17954.htm.
[128] KPMG settled this in April 2005 by agreeing to pay 22 million USD and to give several undertakings as to improve audit practices, see http://www.sec.gov/news/press/2005-59.htm; see also D. Marent, *op. cit*., p. 19.
[129] http://www.nytimes.com/2002/09/13/business/2-top-tyco-executives-charged-with-600-million-fraud-scheme.html (noting a "series of earnings restatements, accounting scandals and sudden bankruptcies at Enron, WorldCom, Adelphia and other big companies.").
[130] D. Marent, *op. cit*., p. 16.

secret, unauthorized and artificially below-market interest or interest-free loans and compensation amounting to hundreds of millions of USD. Moreover, Tyco engaged in a multi-billion dollar accounting fraud causing massive losses.[131] The auditors Scalzo and Price-Waterhouse Coopers failed to detect at an early stage that the loans supposedly taken to pay the tax on stock options, which in reality being utilized for other purposes.[132] PWC did settle claims it failed to perform its duties in a shareholder suit.[133]

The above provided some examples of auditor failure and/or collusion in enabling accounting fraud at U.S. corporations. However, there are many non U.S. examples as well. Malaysia's Transmile Group engaged in a large accounting fraud involving materially false financial statements overstating accounts indicating a profit when in fact the company losses were substantial - 496 million RM. The fraud and irregularities were detected by the auditor Moores Rowland and not by the Company's auditor Deloitte & Touche. The Deloitte firm denied the allegation that it failed to detect the committed fraud claiming that it is not possible to expect auditors to guarantee the fairness of companies' accounts.[134]

Olympus is an archetype example of a severe accounting fraud which led to substantial economic loss.[135]

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[131] See https://www.sec.gov/news/press/2006/2006-58.htm ("Tyco's improper acquisition accounting included undervaluing acquired assets, overvaluing acquired liabilities, and misusing accounting rules concerning the establishment and utilization of purchase accounting reserves. The complaint further alleges that, apart from its acquisition activities, Tyco improperly established and used various kinds of reserves to make adjustments at the end of reporting periods to enhance and smooth its publicly reported results and to meet earnings forecasts.")
[132] D. Marent, *op. cit*.,p. 17.
[133] http://www.nytimes.com/2007/07/07/business/07tyco.html ("PricewaterhouseCoopers, the firm that audited Tyco International when it was run by executives who later went to prison, has agreed to pay $225 million to settle claims of Tyco investors.").
[134] D. Marent, *op. cit*., p.17.
[135] See Floyd Norris, Deep Roots of Fraud at Olympus, http://www.nytimes.com/2011/12/09/business/deep-roots-of-fraud-at-olympus.html?mcubz=0 Dec. 8, 2011 (noting the auditor's role in failing to discover)

> [T]he company has lost 80% of its value since I was dismissed three-and-a-half weeks ago. It has now been put on the watch list by the Tokyo Stock Exchange. It's in a critical position.[136]

Olympus hid financial losses dating back to the 1990s and terminated its former president, U.K. national Michael Woodford, because he disclosed a grandiose accounting fraud by paying exorbitant fees to consultants to cover up the losses.

> Olympus had bought a company called Gyrus for $2bn. That was a very expensive acquisition. We paid 100 times the annual profits for that company. But I found we had paid a fee of $700m and that fee had gone through the Cayman Islands. That's 36% of the value of an acquisition. Normally that type of advice if it was legitimate, would cost around 1%. So it was inexplicable.[137]

Incredibly, the external auditors utterly failed to discover this accounting scam which lasted many years and involved billions of dollars.

The leading Japanese company Toshiba was enmeshed in a huge accounting fraud and conceded, after being caught, that it had engaged in a multi-billions dollar accounting fraud for almost a decade.[138] The once mighty business entity had had its debt cut to junk[139] yet Toshiba

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[136] See Former Olympus Boss Woodford, supra note 153 ("Subsequently, Olympus "apologized" for the dismissal."); see also OLYMPUS CORP., NOTICE CONCERNING PAST ACTIVITIES REGARDING DEFERRAL IN POSTING OF LOSSES (2011), available at http://www.olympus-global.com/en/common/pdf/nr111108e.pdf.

[137] Former Olympus Boss Woodford Blows Whistle on Company, BBC News (Nov. 15, 2011), http://www.bbc.co.uk/news/15742048

[138] See Michal Addady Toshiba's accounting scandal is much worse than we thought http://fortune.com/2015/09/08/toshiba-accounting-scandal/ Sept 8, 2015 ("Toshiba admitted on Monday that it had overstated its profits by nearly $2 billion over the past 7 years, the ***Wall Street Journal*** reports.") Evidently, Toshiba managers "set aggressive profit targets that subordinates could not meet without inflating divisional results were under pressure to report growing profits." Id. After the admission, "Toshiba's shares fell dramatically". Id.

[139] See Finbarr Flynn Toshiba's Credit Rating Lowered Two Levels to Junk by Moody's http://www.bloomberg.com/news/articles/2015-12-22/toshiba-s-credit-rating-lowered-two-levels-to-junk-by-moody-s Dec 22, 2015 ("Toshiba Corp.'s long-term senior bond rating was cut two levels by Moody's Investors Service to Ba2, its second-highest junk rating, from Baa3. That was followed by a downgrade to sub-investment grade by Standard & Poor's.")

managers and officers seemed more concerned about protecting insiders who planned and/or profited from the fraud than promoting the interests of "outsiders" and other "non-allies" even though these "outsiders" are shareholder-owners. As one governance expert notes, there seems to be "100% tolerance" for managerial cover-ups.

Nicholas Benes, representative director of the Board Director Training Institute of Japan, was critical of Toshiba this month when the company said it had identified 30 executives who had been involved in the accounting scandal -- and none of them would lose their jobs. He said the company was showing "100 percent tolerance" for employee wrongdoing in contrast to the zero-tolerance policies at the world's best-managed companies.[140]

While Toshiba has made some efforts at demonstrating "best practices" in terms of governance, the reality is it seems more show than substance.[141] The amount of money sought in recovery from former officers constitutes only a fraction of the actual loss in shareholder value.[142] Moreover, "Toshiba has yet to fully explain why it is limiting its lawsuit to just five former executives, effectively absolving some current officials who were in senior roles during the years it was padding profits."[143] Furthermore, Toshiba had already implemented reform yet the fact this happened speaks volumes: But the fact that the problem was continuing even though Toshiba had already implemented a US-style executive committee board system is an

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[140] Chris Cooper Season of Scandal Hits Japan With Company Confession Flurry http://www.bloomberg.com/news/articles/2015-10-19/season-of-scandal-hits-japan-with-flurry-of-corporate-confession Oct 20, 2015

[141] See MAKIKO YAMAZAK, Toshiba lawsuit highlights Japan governance reform still lacking: lawyers, http://www.reuters.com/article/2015/11/12/us-toshiba-lawsuit-idUSKCN0T10AA20151112 Nov 12, 2015 ("Toshiba Corp's (6502.T) lawsuit against former executives linked to a $1.3 billion accounting scandal is a defensive maneuver that highlights a lack of sincere reform, lawyers and corporate governance experts said.")

[142] See MAKIKO YAMAZAK, Toshiba lawsuit highlights Japan governance reform still lacking: lawyers, http://www.reuters.com/article/2015/11/12/us-toshiba-lawsuit-idUSKCN0T10AA20151112 Nov 12, 2015 ("The 300 million yen ($2.44 million) in damages Toshiba is seeking pales in comparison with the over $7 billion decline in its stock market value since the accounting problems came to light in early April."

[143] See MAKIKO YAMAZAK, Toshiba lawsuit highlights Japan governance reform still lacking: lawyers, http://www.reuters.com/article/2015/11/12/us-toshiba-lawsuit-idUSKCN0T10AA20151112 Nov 12, 2015

example of reform failure. Clearly their outside directors did not function as expected. And neither did the accounting firm that audited Toshiba.[144]

In a case involving the ***Group*** *Bumiputra Commerce-Holdings Bhd (BCHB)*, the company filed a lawsuit against its auditor Deloitte for irregularities detected by the auditor Price-waterhouseCoopers in the accounts of its subsidiary *southern Bank Bhd (SBB)*. The assets of *SBB* were overstated by 160 million RM. *BCHB* did not bring a legal action against the *SBB*'s Board of Directors for lack of evidence on the committed fraud. Deloitte failed to detect the committed fraud as it was engaged its time and efforts in providing non-audit services to this company[145].

Financial scandals and competition for FDI in a globalized world impose on countries the need to modernize their corporate governance systems and in particular, ensure a best practices role of the external auditors. The following Part discusses legal issues and suggestions for reform in Jordan based upon an analysis of the regulation of external auditors in the Jordanian and UK legal frameworks.

V. CRUCIAL REGULATORY ISSUES FOR EXTERNAL AUDITORS IN THE CONTEXT OF CORPORATE GOVERNANCE

The regulation of auditors in a given country is related to that country's legal system which can substantially impact the nature of the auditing regime. In Jordan and the UK, like other code law countries, laws stipulate minimum requirements and rules tend to be highly prescriptive and procedural.[146]

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[144] Masao Nakamura Has Japan's corporate governance reform worked? http://www.eastasiaforum.org/2015/10/23/has-japans-corporate-governance-reform-worked/Oct 23, 2015

[145] For more details about this case, see L. Krishnan, *op. cit.,* p. 5.

[146] In common law countries, such as the United States, laws establish limits beyond which it is illegal to venture, and within those limits experimentation is encouraged. See Stephen Salter & Timothy Doupnik, The Relationship between Legal Systems and Accounting Practices: A Classification Exercise, 5 Advances Int'l. Acct. 3 (1992) (provides empirical support for the hypothesis that a legal system is a significant predictor of auditing practices

In Jordan, the Company Law No. 22 of 1997 ("1997 Company Law") is considered a major source for regulating auditors.[147] In addition to regulating general matters related to companies, the 1997 Company Law specifically governs auditors.

In the UK, the regulatory framework for Companies' audits and auditors is provided by Companies Act of 2006[148], which found its origin in the domestic legislative reforms enacted post-Enron collapse by the Companies Act of 2004. This reform led mainly to the establishment of the Financial Reporting Council (FRC) with a responsibility to enhance the standards of corporate auditing and corporate governance[149]. The final version of the UK Corporate Governance Code of December 2014 and September 2015 applied on 17 June 2016 regulated also certain legal issues relating to the audit profession, such as the issues of auditors' election, their remuneration, the public oversight of the audit profession... The European regulatory framework for companies audit and audit profession is provided by EU Audit Directive of 2006[150] amended recently by the EU Audit Directive of 2014[151]. The two Directives set out certain requirements and qualifications for auditors pertaining to their appointment, independence, professional disciplinary processes, the content of their reports, the standards of their liability.[152] The following subsections consider these issues in detail.

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and concludes that a dichotomization of accounting practices, procedures, and rules consistent with the common law/code law classification of legal systems). In contrast, in code jurisdictions… needs elaboration

[147] See Company Law No. 22 of 1997 as amended by Provisional Law No. 17 of 2003, Official Gazette No. 4589, art. 192. a (March 16, 2003). Other laws relating to auditors include securities, banking, and insurance laws. See Provisional Securities Law No. 76 of 2002, Official Gazette No. 4579 (December 31, 2002). See Banking Law No. 28 of 2000, Official Gazette No. 4448, art. 60 (August 2000). See also Insurance Law No. 33 of 1999 as amended by Provisional Law No. 67 of 2002, Official Gazette No. 4572, art. 40 (November 17, 2002).

[148] SS. 475-539 of Part 16 (Audits) and Part 42 (Statutory Auditors). See also SS. 7-32 of the Local Audit and Accountability Act of 2014.

[149] Financial Reporting Council, the UK Approach to Corporate Governance, October 2010, available at https://www.frc.org.uk/getattachment/1db9539d-9176-4546-91ee-828b7fd087a8/The-UK-Approach-to-Corporate-Governance.aspx, (Last visited January 9, 2017).

[150] Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, OJ L 157, 9/6/2006, p. 87.

[151] Directive 2014/56/EU of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts
http://eur-lex.europa.eu/legalcontent/EN/TXT/PDF/?uri=CELEX:32014L0056&from=EN.

[152] It is worth mentioning that on 23 June 2016, UK voted to leave European Union.

A. Appointment of External Auditors

The mechanism of auditors appointment in Jordanian law is similar to that followed in UK 2006 CA, as presented below.

1. The Jordanian Law

The 1997 Company Law specified which companies should appoint an auditor. These companies include the public shareholding company; limited liability company; and private shareholding company. The Company Law excluded from the list general and limited partnerships and *mahassa* company (silent company).[153] There is no obvious reason why the Jordanian legislator excluded partnerships and *mahassa* companies from those companies whose financial statements must be externally audited. It can be presumed that partnerships and *mahassa* companies are generally small or medium-size companies and their nature does not merit appointment of auditors as they may not maintain organized commercial books. However, these reasons do not justify exclusion from appointing auditors, especially knowing that auditors play an important role in verifying financial reports which are crucial for third parties who deal with partnerships and *mahassa* entities. The Company Law should be amended so as to oblige these companies to, at least, divulge this information in all their contracts and communications to alert third parties.

In addition, company management nominates the auditor(s) among those authorized to practice the audit profession in Jordan. At the annual general shareholders meeting, the shareholders vote either in favor of or against that auditor.[154] Significantly, the right of

[153] *Mahassa* company is a type of company that neither acquires juristic personality nor partners acquire the quality of merchants. Third parties are unaware of the existence of *mahassa* company. Thus, third parties have recourse only against partners in the *mahassa* company with whom they have dealt so long as the existence of the company is undisclosed. If the *mahassa* company is disclosed to third parties, it is treated as a general partnership with respect to such third parties. See Michael J.T. McMillen, Islamic Shari'a-Compliant Project Finance: Collateral Security and Financing Structure Case Studies, 24 Fordham Int'l L.J. 1184, 1233 (2001).

[154] See Company Law No. 22 of 1997, *supra* note 19, art. 192.a

shareholders to elect an auditor is rarely exercised. Moreover, the ability to select the auditor or to effectuate a change to a new auditor is substantially reduced because of the ownership structure in many Jordanian companies. In reality, the general meeting of shareholders rubber stamps the decision of selecting an auditor which has already been made by management. Therefore, the process of selecting an auditor can be more accurately described as an "appointment" by the controlling owner rather than a true election. A further issue that arises is the fact that the majority of Jordanian companies have concentrated ownership.[155] Based upon the ownership structure in many large companies, the controlling shareholder generally selects the auditor. This dominance negatively affects the role of minority shareholders who often, as a result, are not interested in attending the corporate's general assembly meeting.

Moreover, with respect to being listed as a "qualified auditor", the Company Law of 1997 did not include specific qualifications, whether academic or professional, for auditors. Rather, the matter of qualifications is referred to the Provisional Law on Organizing the Audit Profession No. 73 of 2003.

Making the selection of an auditor even more problematic is the potential retention of a lackluster auditor. While auditors are appointed ostensibly for only one year renewable terms,[156] The Company Law does not determine if the one-year period is renewable once or indefinitely. Based upon this legal loophole once an auditor is selected he has the job until dismissed by the general meeting of shareholders since it is this authority which vested the auditor with the role[157]. In other words, an auditor can be dismissed only in the same manner in which he was elected. This raises the specter of a dominant or controlling shareholder

[155] See World Bank, Corporate Governance Country Assessment: Jordan 1-2 (2004), available at (http://www.worldbank.org/ifa/jor_rosc_cg.pdf>, (last visited October 26, 2022).
[156] See Company Law No. 22 of 1997; *supra* note 19, at art. 192.a.
[157] *Id.* Art. 171.

continuing to place a "favorite" auditor in the position raising potential conflicts of interest and loyalty. We suggest the Companies Law be amended …

In the event the general meeting of shareholders fails to elect an auditor, then the board of directors shall nominate three auditors at least to the Companies Controller of the Ministry of Industry and Trade in order to choose one among them.[158] In this instance, the Company Law 1997 refers the matter to the Companies Controller considering the fact that it is the umbrella entity responsible for monitoring and regulating companies in Jordan.[159] Rather than invoking this time consuming process that divests the right from the shareholders, the Company Law should be amended to provide that a second opportunity to elect an auditor will be allowed at an extraordinary meeting of shareholders. Under this proposal, only if the extraordinary meeting of shareholders fails to elect an auditor, would the Companies Controller intervene.

Remuneration of the auditor is determined by the general meeting of shareholders[160] Audit remuneration in Jordan is regarded as low especially if compared with other countries. For example, audit remuneration for public shareholding companies stands at JD 1500 (equivalent to US $2116).[161] Arguably, managers of companies do not appreciate or value the role of auditing and perceive auditing as a service that does not provide tangible value. Alternatively, it may be the self-interest of managers who have conflicts of interest with the company that "incentivizes" low compensation so as to avoid substantial scrutiny. Company management might not want to push for higher fees to avoid comprehensive review. Indeed, the low level of auditor's remuneration may adversely affect his performance since he may not

[158] *Id*. art. 192.b.
[159] See Companies Controller Directorate, An Overview 2-3 (2007)
[160] See Company Law No. 22 of 1997, *supra* note 19, at art. 192.a. See also Jordanian Court of Cassation, Case No. 2002/575, Adaleh Publications (March 13, 2002).
[161] See Jordan Association of Certified Public Accountants, Circular (June 19, 2007).

be able to meet all required duties at such a remuneration level.[162] Further regulations should set a minimum level of auditor's remuneration commensurate with his duties and risks. However, from the auditor's point of view, auditors often admit the audit missions offered at low prices in the hope that they will deliver profitable consultancies and non-audit services for the same client.

In addition to the external company auditor, audit committees play a vital role in accounting matters. Audit committees of corporate boards of directors are central to corporate governance in many countries.[163] Audit committees oversee, among other things, the financial reporting process which is important to promote reliable financial statements. Thus, Audit committees protect investors and other stakeholders by aiding in deterring, detecting, and preventing fraudulent financial reporting. In 1998 the Jordanian Securities Commission introduced the Audit committee requirement obligating listed companies to establish an audit committee every year. This committee is comprised of three non-executive members of the board of directors. It has to meet a minimum of four times a year, and has the full power to request information and advice from internal and external source. The committee is responsible for reviewing and discussing the reports and statements of the internal and external auditors, and the company's financial statements. According to the Guide of Jordanian Shareholding Companies of 2003, the number of public shareholding companies is almost 200, and they are all required to establish audit committees[164].

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[162] However, courts in Jordan held that auditors should do their job in proper manner even though their remunerations were low. See Court of Cassation, Case No. 1976/135, Jordanian Bar Association Journal 1907 (January 1, 1976) (Although the auditor audits accounts for the company once or twice a month and his fees are low, he must do his work properly).

[163] See Kon Sik Kim, Transplanting Audit Committees to Korean Soil: A Window into the Evolution of Korean Corporate Governance, 9 Asian-Pacific L. & Pol'y J. 163, 171-180 (2007) (discussing which directors should serve on the audit committee, the scope of its duties, and how it should operate).

[164] 644-42201-1-PB (1), Jordan.

2. The UK Law

In the UK every company must appoint its external auditor for a period of one or more financial years unless its directors reasonably resolve that audited accounts will not be required in that financial year[165]. In the case of listed companies, which are not qualified as dormant, the appointment of auditors must be made before the end of accounts meeting[166]. The appointed auditors, whether being individuals or firms, must be well qualified, independents and members of recognized supervisory bodies[167]. The Secretary of state has the right to organize the terms for disclosure of the conditions according to which auditors are appointed or remunerated.[168]

The appointment of auditors by the companies causes in most cases a conflict of interests even if they are appointed by shareholders and not the management[169]. Auditors admit frequently to offering their statutory audits at low fees or even below costs as they know that they will have great opportunities to provide lucrative consulting works, such as taxation matters, corporate restructuring, information technology and human resources consultancies for the same client[170]. In other words, the assumed incentives and the frequent influence of the executive management and dominant investors on the choice of auditors compromise their independence and make them afraid of losing their mandates if detecting management mistakes[171].

According to sections 477 and 480 of CA 2006, the dormant and small companies are exempted from audit. In the case of dormant company, it is exempted from audit if it has been dormant since its formation or since the end of its previous financial year, and it is not

[165] S. 485-1 & 489-1 of CA 2006.
[166] S. 489-2 of CA 2006.
[167] SS. 1212 , 1214 & 1219of CA 2006.
[168] S. 493 of CA 2006. See in this regard, W. Doralt et al., Auditor Independence at the Crossroads - Regulation and Incentives, European Business Organization Law Review, March 2012, Vol. 13, Issue 1, p. 92.
[169] Art. 37-1 of the Audit Directive 2014.
[170] See The influence of the management on the appointment of the auditor, W. Doralt et al., *op. cit.*, p. 92.
[171] *Id.*

excluded company of this category by the fact that it is a financial services company[172]. A dormant company may be either a private or a public company. A company is qualified as a small company if its turnover in a financial year is not more than 5.6 million GBP and that its total balance sheet for that year does not exceed 2.8 million GBP[173], and it is not excluded company of this category by the fact that it is a public company or a financial services company or a special register company[174]. The exemption of small companies was defended on the ground that the shareholders in these companies are in most cases their directors and all concerned persons in such companies are often members of the same families, so they do not need accounts audit. Even though, it seems clear that not all small companies are totally owned by members of same families or their directors, the minority shareholders who are not directors or members of one family should be protected and reassured of an audited financial accounts[175].

In both cases, a dormant or a small company is entitled to the audit exemption under the condition that the directors states in the balance sheet that the company is entitled to the exemption, shareholders having (10%) of the shares have not requested an audit and that they acknowledge their responsibility for keeping financial and accounts records[176].

Concerning the remuneration of the auditor, it is fixed by the entity who appoints him. Therefore, the remuneration of the auditor appointed by the members of a company must be fixed by them by ordinary resolution. Likewise, the remuneration of the auditor appointed by the directors of a company must be fixed by them in the appointment decision or in a separate document. Alike, the remuneration of the auditor appointed by the Secretary of State must be

[172] SS. 480 & 481 of CA 2006.
[173] S. 477 of CA 2006.
[174] S. 478 of CA 2006.
[175] B. Hannigan, *op. cit*., p. 394.
[176] S. 475 & 476 of CA 2006.

fixed by it[177]. Listed companies are required to submit a detailed auditor's remuneration report including all kinds of fees and remuneration received by him.

An audited company has the right by an ordinary resolution to remove at any time its auditor from office or appoint another one after expiry of his term[178]. An auditor may also resign at any time his office by sending a written notice to the company's registered office which must send a copy of this notice to the companies' registrar[179].

B. External Auditor's Independence

National and international efforts were focused on introducing stricter procedures and regulations in order to ensure auditors' objectivity and independence. In the two subsections below, we will present in detail the approach adopted by both legislators in Jordan and the UK.

1. The Jordanian Law

The auditor must be objective in reviewing financial statements and an auditor's independence from his client is one of the hallmarks of superior corporate governance.[180] To be objective, the auditor must from the outset of the relationship and continuing throughout the engagement maintain his independence. The 1997 Company Law does not define the term "independence."[181] Rather, it enumerates the kinds of relationships and activities that create conflicts of interest and could cause the auditor to jeopardize his independence. For example, an auditor is prohibited from participating in the establishment of a public shareholding

[177] S. 492 of CA 2006.
[178] SS. 510 & 514 of CA 2006.
[179] SS. 516 and 517 of CA 2006.
[180] See in this regard, the International Standard on Auditing 220 Quality Control for an Audit of Financial Statements, available at: http://www.ifac.org/system/files/downloads/a010-2010-iaasb-handbook-isa-220.pdf. (last visited March 3, 2022).
[181] In the U.S., the Independence Standards Board provided a definition of independence for auditors. Auditor independence is both independence of mind - freedom from the effects of threats to auditor independence and independence in appearance - absence of circumstances that would lead well-informed investors and other users to conclude that there is an unacceptably high risk that an auditor lacks independence of mind. See Sean M. O'Connor, Strengthening Auditor Independence: Reestablishing Audits as Control and Premium Signaling Mechanisms, 81 Wash. L. Rev. 525, 566-568 (2006).

company.[182] He is also barred from serving as a member of a company's board of directors, partner to any member of board of directors, or employee of any board member.[183] These prohibitions are designed to disconnect the auditor from any financial interest whatsoever in the company.

Over the years prior to the 1997 law, auditing firms have come to offer many types of services to their audit clients.[184] After the issuance of this law, the ability of auditing firms to perform such services was limited. The 1997 Company Law prevents an auditor from providing "permanently" any technical, administrative or consultancy services to a company whose accounts he audits.[185] In other words, an auditor is not permitted to engage in non-audit services which can include, for example, financial consulting, pension services, and marketing services.[186] Additionally, by providing non-audit services, companies can exercise leverage over auditing firms to influence their opinions on the financial statements. Therefore, any non-audit service provided to clients will violate the 1997 Company Law prohibitions.

However, the prohibitions are limited to "permanent" delivery of non-audit services. Thus, "temporary" or "circumstantial" delivery of non-audit services may be permitted. The 1997 law did not also require listed companies to disclose non-audit services. In our view, this law should be amended to specifically prohibit the delivery of non-audit services without distinction between permanent and temporary because both have the same undesirable effects

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[182] See Company Law No. 22 of 1997, *supra* note 19, at art. 197. Thus, an auditor could be prohibited from acting as a promoter or underwriter.
[183] *Id*.
[184] See Andrew D. Bailey, Jr., The Multi-Disciplinary Practice of Certified Public Accountants and Lawyers, 52 Case W. Res. 895, 897, 902 (2002) (the breadth of non-audit client/management services had increased to the point that it is the norm to refer to the "business" of public accounting rather than the "profession").
[185] Art. 197.
[186] See Matthew J. Barrett, "Tax Services" as a Trojan Horse in the Auditor Independence Provisions of Sarbanes-Oxley, 2004 Mich. St. L. Rev. 463, 472, 486 (2004). Auditing firms have attempted to expand their services to include certain legal services. See Alison H. Mijares, The Securities and Exchange Commission's Ban on Legal Services by Audit Firms: Amendments to Rule 2-01 of Regulation S-X Under the Securities Exchange Act of 1934, 36 U.S.F. L. Rev. 209, 226-228 (2001).

and raise serious conflicts of interest with respect to the external auditors' likely to negatively impact their performance.[187]

Conversely to the position adopted by 1997 law, the Corporate Governance Codes of 2009 prohibited all kinds of non-audit services. The Code states clearly that companies must ensure that their external auditors do not provide them with any extra works and services, including technical consultation or administrative support[188]. The adoption of this position by the Company Law would bring Jordan in line with global best practices and enhance good corporate governance.

Another significant area for improvement is the meaning of the term “independence” found in the 1997 Company Law.[189] The term is general and in some cases can be interpreted ambiguously. For example, the 1997 Company Law does not define with sufficient clarity the term "participation" in the establishment of a company which would prohibit an auditor from delivering his services to this company. Because there is no guidance, interested parties may have difficulty applying the existing independence rules to the large number of potential permutations. Moreover, the 1997 Company Law refers to absolute prohibition when listing its independence rules. The law should permit certain activities but restricting their extent or permit certain activities but requiring the auditor to publicly disclose information about them.

No judicial decisions exist in which an auditor's independence was an important issue and therefore Jordanian courts have not yet ruled on the definition of “independence”. Due to the non-existence of judicial cases that address auditor independence, courts have not had the

[187] The Audit committee may help in investigating the kinds of works that auditors deliver and see whether it would be in commune interests of investors to have some of those works performed by a third party. This committee can thus play an effective role in moderating management attempts to force auditors into admitting wrong accounting treatments. See H. Al-Khaddash, *op. cit*, p. 208; I. Adelpo, *op. cit*., p. 61.
[188] Chapter 5, S. 4-3-b of the Code.
[189] Art. 8-e.

opportunity to act as policymakers in this area. Thus, the Jordanian legislator ought to modernize independence rules of the Company Law to be more finely tuned.

In the context of auditors rotation, the long tenure of an auditor has the potential to act as a negative factor with regard to independence as their long-term retention is likely to produce a cozy relationship with management. To reduce this possibility, some authors have suggested mandatory audit rotation every five years. The Jordanian Corporate Governance Codes of 2009 mandated auditors rotation in stating that "*the external auditor shall exercise his duties for one year renewable, provided that the renewal for the partner at the external auditor may not be for more than four consecutive years, and the re-election may not take place before a minimum of two years*".[190]

2. The UK Law

On the international level, auditors are subject to the ethical requirements that have been codified by the International Ethics Standards Board of Accountants[191]. In the UK, auditor independence is regulated by the Auditing Practices Board and the Corporate Governance Code published by the Financial Reporting Council. However, even after the issuing of these regulations, auditors are still allowed in the UK to supply non-audit services to their audited companies provided that these companies disclose clearly the details of the remuneration paid to auditors in their financial statements[192].

In such an environment, the auditor should always prove able to fully resist the pressure of his client. He must ensure the quality of the audit works and the reliability of company's

[190] Chapter 5, S. 4-2 of the Code.
[191] ICAS CODE OF ETHICS , January 2014, available at https://www.icas.com/ data/assets/pdf_file/0008/2006/F8001-ICAS-Code-of-Ethics.pdf, (Last visited January 13, 2022)
[192] S. Fearnely & V. Beattie, *op. cit.,* p. 119; M, Habbash, The effectiveness of corporate governance and external audit on constraining earning management practice in the UK, thesis, Durham University Business School, 2010, p. 85.

financial accounting process[193]. He can also help management, board and audit committee in ensuring the credibility and reliability of the financial reports provided by other company's members[194].

The company's audit committee should enhance the auditor's objectivity and independence, and ensure that he is free from the influence of management. The committee should also support the auditor and encourage him to be fair and transparent on all material and financial issues at an early stage[195].

In this context, the UK Corporate Governance Code required companies to nominate an audit committee of non-executive directors to assess on an annual basis the auditors' objectivity and independence[196]. The committee should take into its consideration the related UK law and professional requirements. Furthermore, it must seek reassurance that the auditor and its staff do not have any business, family or employment relationship with the audited company[197]. The committee must also recommend to the board of directors a strict company's policy with respect to the provision of non-audit services by the company's auditor[198]. The committee should on an annual basis seek from the company's auditor all information about his policies and processes for sustaining his independence and, at the same time, observing his compliance with these policies and the related ethical requirements, including policies on non-audit services and the rotation of audit partners and staff[199]. In this context, in order to ensure that the provision of non-audit services adopted by the company does not impair the auditor's objectivity and independence, the audit committee must take into consideration the nature and

[193] See Auditor Independence Policy- Why Auditor Independence Matters?, Audit Review, May 2012, available at, http://auditreview.co.uk/downloads/Auditor_Independence_Policy.pdf , p. 4, (Last visited September 25, 2022).
[194] D. A. SIMUNIC, Auditing, Consulting, and Auditor Independence, Journal of Accounting Research Vol. 22 No. 2, Autumn 1984, p. 683.
[195] I. Adelpo, *op. cit*., p. 62.
[196] C.3.1. of the UK Corporate Governance Code of 2014.
[197] *Id.,* C.3.2.
[198] *Id.,* C.3.8.
[199] *Id.*

types of these services (bookkeeping, corporate restructuring, tax services, management consultation…), and whether the experience and skills of the auditor make him the suitable provider of it[200]. The committee must also consider the fees charged or to be charged for these services and the criteria that govern the compensation and remuneration of the auditor[201].

For public companies, the company's auditor must provide the audit committee of a written disclosure of relationships that could impair the auditor's independence, the details of non-audit services and the fees incurred, a written confirmation of his objectivity and independence, any inconsistencies between the Ethical Standards regulated by the Auditing Practices Board on non-audit services and the audited company's policy for providing these services.[202]

Mandatory rotation of the company's auditor plays a vital role in strengthening his independence. This rotation would break the expectation of the auditor that his audited client is a permanent financing source[203].

C. External Auditor's Report and its Content

The origin of the modern auditor's report can be traced to late nineteenth century British audit reporting practices.[204] The purpose of the auditor's report is to evaluate a company's financial information and state the auditor's opinion of the balance sheet and profits and losses account, as presented below.

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[200] S. Fearnely & V. Beattie, *op. cit.,* p. 120.
[201] *Id.,* C.3.2.
[202] S. Fearnely & V. Beattie, *op. cit.,* p. 120..
[203] See W. Doralt et al., *op. cit*., p. 96
[204] See Marshall A. Geiger, Setting the Standard for the New Auditor's Report: An Analysis of Attempts to Influence the Auditing Standards Board, 1 Studies in Managerial and Financial Accounting 7-12 (1993).

1. Auditor's Report Under Jordanian Law

Auditors are required to present a report to the general meeting of shareholders and the 1997 Company Law sets forth the mandatory information that must be included in the auditor's report.[205] The company whose accounts are being audited must facilitate the job of the auditor furnishing documentation if requested by the auditor. The auditor report should provide this statement whether or not he obtained the necessary information and clarifications. In the auditor's report, the auditor must include a statement that the company's management and board of directors provided him with information or statements he requested and facilitated his audit.[206]

The auditor, in his report, is required to disclose if the company maintains accounts, the extent to which financial statements are prepared according to internationally accepted accounting and auditing standards, and the company's financial statements confirmed with its books.[207] Again, the auditor should provide this information whether or not the company maintained accounts or not. The Jordanian legislator could have required the auditor to disclose this information only if the company does not maintain accounts or its financial statements are not prepared according to internationally accepted accounting and auditing standards.

The auditor report must state that the auditing procedures carried out by him form, in his opinion, a reasonable basis to express his opinion regarding the company's financial position, and results of its operations and cash flow according to internationally accepted auditing standards.[208] Hence, not only does the 1997 Company Law require the auditor to state that the auditing procedures form a reasonable basis to express his opinion, but also specifies the type of information and documents that this obligation applies to. The information and

[205] See Company Law No. 22 of 1997, *supra* note 19, at art. 193.g.
[206] *Id*. art. 195.a.1. The Jordanian legislator could have required the auditor to provide this statement only if he does not obtain the needed information. Thus, the auditor would not be required to supply this statement if he obtained the information. However, the Jordanian legislator opted to require the auditor to supply this statement whether he obtained the information or not.
[207] *Id*. art. 195.a.2.
[208] *Id*. art. 195.a.3.

documents are the company's financial position, results of its operations, and cash flow statement.

The report also must include an item stating that the financial statements found in the board of director's report to the general meeting of shareholders comply with the company's records and registers.[209] Once again, the auditor must state this item in his report whether or not the financial statements comply with the company's records and registers.

The auditor should report any violation of the 1997 Company Law or the company's articles of association that is committed during the year and which has a material effect on the financial position of the company, and whether any such violation still exists.[210] The auditor's report of any violation must be within the limits of the information available to him or that is knowable based upon his professional duties.[211]

This means that auditors are not required to detect violations. But if these violations are discovered in the course of the auditor's duty and within the limits of information available to him, the auditor then should report them as required by the law. In other words, the auditor cannot play the role of a detective and examine every suspicious case *ex officio*.

Moreover, not every violation of the 1997 Company Law or the company's articles of associations must be reported. The auditor is only obligated to report any violation that has a "material effect" on the company's operations or its financial position. The law does not provide a definition of "material effect" or provide examples of violations that have material effects. Additionally, the Company Law does not require the auditor to immediately notify the board of directors or the Companies Controller if he discovers any violation that adversely

[209] *Id*. art. 195.a.4.
[210] *Id*. art. 195.a.5.
[211] *Id*.

affects the financial position of the company. To the contrary, any mention of violations must be made in the auditor's report.

In reporting violations, a question could arise with regard to the status of violations that are committed but fixed later. Is the auditor required to report these violations or not since they were dealt with? The Company Law of 1997 does not provide an express answer. However, by looking at the general language used in reporting violations, one can assume that any violation must be stated in the auditor's report whether this violation still exists or has been resolved.

After the audit is complete, the auditor has several options with regard to opening on the company's balance sheet and profits and losses account.[212] First, the auditor can approve without reservation the balance sheet, profits and losses account, and cash flow. Second, the auditor approves with reservation the balance sheet, profits and losses account, and cash flow provided that he justifies his reservation. Third, the auditor does not approve the balance sheet, profits and losses account, and cash flow with a justification for this rejection. In the latter case, the auditor sends the financial statements to the board of directors whereby the general meeting of shareholders requires the board to correct these statements.[213] If the board of directors refuses to make the necessary changes to bring financial statements into conformity, the matter will be referred to the Companies Controller who appoints licensed auditors to settle the issue.

The Company Law does not grant the auditor the right to issue an adverse opinion if he finds that financial statements do not show the company's true financial position.[214] The result, according to the Company Law of 1997, is that auditors can provide a total of three opinions:

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[212] *Id*. art. 195.b.
[213] *Id*. art. 196.
[214] See Lawrence A. Cunningham, Facilitating Auditing's New Early Warning System: Control Disclosure, Auditor Liability, and Safe Harbors, 55 Hastings L.J. 1449, 1454-1460 (2004) (discussing the circumstances leading to the issuance of adverse opinion and other forms of qualified opinions).

one opinion on balance sheet, one opinion on profits and losses account, and one opinion on cash flow. The three-opinion arrangement creates the possibility of different combinations of opinions. For example, these combinations may include the case of approval without reservation or non-approval on all or approval without reservation on balance sheet and non-approval of profits and losses account and cash flow.

There is no mention in the Company Law of the auditor's responsibility to attest to or certify the truthfulness of financial statements. The auditor does not opine on the accuracy of the financial report. Instead, the auditor opines that the financial statements "present fairly."[215] The auditor's report is not a certification of a fact but an expression of opinion based on professional judgment. In other words, the auditor's job is to express an opinion on the financial statements, which are the responsibility of the company's management, based on his audits. In sum, the audit report is not a guarantee and audits do not evaluate all recorded transactions for a company.[216] Audits are conducted by choosing a sample of transactions on a predetermined basis and determining if the sample chosen is properly recorded.

The public in Jordan has been more willing to question the quality of auditors' work. Questioning of an auditor's work is due to the gap between what auditors actually deliver and what the public usually expects, known as the expectation gap.[217] This gap refers to a

[215] The notion of "presents fairly" is a source of continuing debate and controversy over its intended meaning because reasonable minds will differ as to when the financial statements "presents fairly" its results. The point at which financial information no longer "presents fairly" will differ based upon the judgment, experience, and tolerance level of the auditor. See Arthur Acevedo, How Sarbanes-Oxley Should be used to Expose the Secrets of Discretion, Judgment, and Materiality of the Auditor's Report, 4 DePaul Bus. & Comm. L.J. 1, 24 (2005).

[216] Much of what an audit requires is a review by the auditor of the accounting principles used by the company and an analysis of the estimates made in preparation of the company's financial statements. The application of these principles depends on the particular business situation. Estimates can vary greatly as well. The auditor may interview management, confer with outside sources, and look to industry standards to determine if the principles applied and the estimates made are reasonable.

[217] See Where was the Auditor in Jordan, Vol. 1.2 The Auditing Journal 1 (1990). See also Amending Accounting Information is not the Auditor's Authority, Vo. 2.6 The Auditing Journal 1 (1991).

difference between auditors' understanding of their function and investors' expectations of the auditor's role.[218]

1. Auditor’s Report In The UK Law

The principal objective of an auditor is to prepare a reliable annual financial report to the company's members[219]. It must be described in this report the scope of the audit task and identified the accounts and applied financial reporting framework[220]. To assist auditors in performing their tasks and duties, they have the right to access at all times to the books and accounts of audited companies and they have the right to require companies' managements to provide them with these information and explanations[221]. An auditor has the right also to receive all communications relating to the company's proposed written resolution[222].

According to Section 495-3/a of CA 2006, the report must state obviously whether in the opinion of auditor the company's annual accounts provide a true and fair view: *"(i) in the case of an individual balance sheet, of the state of affairs of the company as at the end of the financial year, (ii) in the case of an individual profit and loss account, of the profit or loss of the company for the financial year, (iii) in the case of group accounts, of the state of affairs as at the end of the financial year and of the profit or loss for the financial year of the undertakings included in the consolidation as a whole, so far as concerns members of the company*".

The report must also state whether the company's annual accounts have been correctly prepared in consistence with the relevant financial reporting framework and the requirements

[218] The expectation gap has been examined in several countries in academic and practitioner literature including the United Kingdom, Canada, and the United States. See David F. Birke, Toothless Watchdog: Corporate Fraud and the Independent Audit - How Can the Public's Confidence Be Restored? 58 U. Miami L. Rev. 891 (2004). See also Donald C. Langevoort, Managing the "Expectations Gap" in Investor Protection: The SEC and the Post-ENRON Reform Agenda, 48 Vill. L. Rev. 1139 (2003).
[219] *Id*. S. 495-1.
[220] *Id.* S. 495-2.
[221] S. 499 of CA 2006.
[222] *Id*. S. 502.

of the Company Act and, if applicable, article 4 of the IAS Regulation[223]. The report must be either qualified or unqualified or qualified[224], and must contain a reference to any issued to which the auditor wishes to draw attention by way of emphasis without qualifying his report[225].

The report must state also whether in auditor's opinion the information provided in the report of directors for the financial year for which the accounts are prepared in accordance with those accounts[226]. The auditor must state in his report whether that part of the audited directors' remuneration report has been properly prepared[227].

If in the auditor's opinion the adequate accounting records have not been kept, or the accounts are not in consistence with the accounting records, or the auditable part of the report of directors' remuneration is not properly prepared, he must so state in his report[228]. If the auditor fails to obtain all the information needed for performing properly his audit task, he must state that fact in his report[229]. If the company's directors have prepared accounts and reports inconsistent with the small companies regime and in the opinion of auditor they were not so entitled, the auditor must state so in his report[230]. The auditor must state also in his report any information undisclosed for the director's benefits and remuneration if it is disclosure is required[231]. The report must state the names of the auditors and shall be signed and dated by them[232].

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[223] *Id*. S 495-3/b & c.
[224] An unqualified report issued when the financial statements are prepared truly and fairly in all material issues in accordance with applicable standards auditing and the relevant statutory acts. A qualified report issued when there is a disagreement with company's management regarding the appropriate financial policies, a limitation on the scope of audit, a conflict between applicable financial reporting frameworks. See about these meanings, Section 539 CA 2006.
[225] *Id*. S 495-4.
[226] *Id*. S. 496.
[227] *Id*. S. 497.
[228] *Id*. S. 498-2.
[229] *Id*. S. 498-3.
[230] *Id*. S. 498.4.
[231] *Id*.
[232] *Id*. S. 503.

Based on the International Standard on Auditing No. 700, the auditor must state in his report that the preparation of the financial statements are the responsibility of company's directors while his responsibility is to audit them.

These are details requested to be included in the audit report[233] in order to provide assurance to the report users such as shareholders, investors, lenders…, and to help them evaluate and make their right decisions. The auditor issue a disclaimer when he is unable to express his opinion about the trueness and fairness of the financial accounts and reports due to substantial restrictions by company's directors or a severe limitation on the scope of audit. He is entitled to issue an adverse opinion when he believes that the financial reports are not prepared truly and fairly nor respected the applicable accounting standards[234].

D. Attendance of the General Meeting of Shareholders

1. Jordan

The Company Law compels the auditor to attend the general meeting of shareholders[235] enabling shareholders to discuss with him directly issues that arise from the financial statements of the company.[236] We suggest modifying the law by empowering shareholders to request a meeting with the auditor without the presence of board of directors or management. The purpose of such a meeting is to communicate with the auditor without any influence of the board of directors on the agenda of the meeting which may occur in the general meeting of shareholders. Meeting with the auditor in the absence of the board of directors can take place either before or after the general meeting of shareholders.

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[233] The same details are required by the article 28 of the EU Audit Directive of 2014.
[234] K. Fiolleau, How Do Regulatory Reforms to Enhance Auditor Independence Work in Practice?, Contemporary Accounting Research Journal, Vol. 30 No. 3, Fall 2013, p. 867.
[235] See Company Law No. 22 of 1997, *supra* note 19, at art. 198.
[236] *Id*. art. 199-b.

2. The UK

According to the Section 502-2 of the UK Company Act of 2006 a company's auditor is entitled to receive all notices and communications relating to any shareholders' general meeting which a company's member is entitled to receive. By virtue of this Section, the auditor has the right to attend any general meeting of the audited company and to be heard at any general meeting which he attends on any part of the business of the meeting which concerns him as auditor. In the case where the auditor is a firm, the right to attend or be heard at a general meeting may be exercised by a person authorized by the firm in writing to act as its representative at this meeting.

E. Liability of External Auditors

The revelation of fraudulent accounting and the ensuing financial losses always triggers the question of whether and to what extent auditors may have liability for damages. In the two subsections below, we will review the liability regime of auditors in Jordan and UK laws.

1. The Liability Regime In Jordan

Liability for failure to provide accurate reporting is an important incentive for auditors to be honest and pursuant to the Company law 1997, external auditors are potentially liable for failing to fulfill their obligations.[237] Liability derives from relevant auditing standards and various laws and auditors can be sued by the company in which they audit its accounts, shareholders, and users of financial statements.[238] Users of financial statements include investors and banks that as a result of relying on the auditors' opinion will likely make poor investment decisions or extend loans and credit.[239] Violations of the Company Law carry

[237] See Jordanian Court of Cassation, Case No. 1998/336, Adaleh Publications (May 9, 1998) (the auditor is the one who drafts the auditor's report and signs it. Thus, the auditor is liable for what is stated in his report).
[238] See Company Law No. 22 of 1997, *supra* note 19, at art. 201.
[239] It is not an easy task to determine which users of financial statements or third parties could benefit from the audited statements and thus the auditor can liable to. The United States apply one of four legal standards to decide which non-clients have a cause of action against auditors: (1) privity; (2) near- privity; (3) the known users; and (4) the reasonable foreseeability rule. These four standards lie on a continuum. They can lead to different outcomes about whether the non-client has a right to sue even when they are applied to the same set of facts. See

compensatory damages and criminal penalties.[240] However, the Company Law does not determine the level or range of damages and jail sentences.

If the company has more than one auditor who committed an illegal act or erred, then they are jointly liable for the losses.[241] Under joint and several liability, one auditor can be held liable for all damages in an action. The joint and several liability system seems unfair as one auditor can be held liable for all damages despite the fact that he committed insubstantial or marginal audit error.

A time limit is set for bringing a civil suit against an auditor. The statute of limitations period is three years starting on the date of the company's general shareholders meeting where the auditor's report is read.[242] The purpose of the time limitation is to require diligent prosecution of claims, thus providing predictability and finality.[243]

The liability language of the 1997 Company Law suggests that the auditor has broad and potentially unlimited liability and can be sued for mere negligence. However, being liable for mere negligence may be unduly harsh given the fact that routine errors do occur. The law should be improved by limiting the liability of an auditor to misconduct that rises to a level of gross negligence or worse (recklessness, intentional). For example, an auditor should be held liable if he acted with the intent to deceive or committed grossly negligent conduct. Alternatively, an auditor's responsibility could be limited in proportion to his fault as opposed to the existing joint and several liability. Comparative proportional liability allocates fairly the liability between the company's management and the auditor thus discouraging inflated claims and encouraging everyone to be aware of his responsibilities and to act diligently.

Denzl Causey, Accountants' Liability in an Indeterminate Amount for an Indeterminate Class: An Analysis of Touche Ross & Co. v. Commercial Union Ins. Co., 57 Miss. L.J. 379, 380 (1987).

[240] See Company Law No. 22 of 1997, art. 201.

[241] *Id*.

[242] *Id*.

[243] *Id*.

Liability of auditors for negligence has only been tested a few times in Jordanian courts[244] and actual penalties and verdicts against auditors are difficult to obtain.[245] Currently, no auditor liability insurance is available.[246] In contrast, Canada, the United Kingdom, Australia, New Zealand, and the United States have witnessed a substantial increase in auditor litigation.[247] The Company Law in Jordan should specify the level of penalties and increase them to enhance the credibility of the audit profession and reduce possible abuse of minority shareholders and other stakeholders by auditors and management.

2. The Liability Regime In The UK

Shareholders and stakeholders rely on the audited accounts in making their investment decisions[248] and the auditor owes the duty of care with respect to the audit. In the case where the auditor violates his continuous duty of reasonable care and skill, there are two types of claims under the UK liability regime that might be filled against him: claims by his client which will be a direct claim based on the violation by the auditor of his obligation

[244] In those few cases, auditors were prosecuted mainly on accusation of dishonesty but not on the basis of not reporting illegal acts or not applying professional standards of due care. Telephone Interview with two lawyers linked to corporate fraud cases in Jordan who asked for anonymity (April 21, 2010).

[245] Auditors involved in those cases were handed innocent verdicts or low level of penalties that can fall by obsolescence or general pardon given by the King on certain occasions and covering certain crimes. *Id*.

[246] Insurance would cover honest mistakes of judgment, but not intentional misbehavior. Persons would not want to occupy auditor positions unless they were protected in situations where they had simply committed errors of judgment. With insurance, moreover, a corporation does not have to bear the entire cost of auditor negligence, because the risk of misfeasance is spread among all corporations as a cost of doing business. See Lawrence A. Cunningham, Securitizing Audit Failure Risk: An Alternative to Caps on Damages, 49 Wm and Mary L. Rev. 711 (2007). See also Lawrence A. Cunningham, Choosing Gatekeepers: The Financial Statement Insurance Alternative to Auditor Liability, 52 UCLA L. Rev. 413, 427-429 (2004) (auditors use general malpractice liability insurance to cover all engagements).

[247] For example, in 1994 at least Canadian $1.3 billion of unresolved claims were pending against Canadian accountants. In the United Kingdom, the Big Six (now Big Four) accounting firms faced 627 outstanding legal cases claiming damages of 20 billion by mid-1994. In Australia, accountants faced more than Australian $3 billion in claims by mid-1993. In New Zealand, the cost of defending legal actions brought against accountants has become a major business problem. In the United States, in 1993, the Big Six accounting firms' expenditures for settling and defending lawsuits were $ 1.1 billion or 11.9% of U.S. domestic auditing and accounting revenue. See Carl Pacini, Mary Jill Martin, and Lynda Hamilton, AT the Interface of Law and Accounting: An Examination of a Tend toward a Reduction in the Scope of Auditor Liability to Third Parties in the Common Law Countries, 37 Am. Bus. L.J. 171, 173 (2000). See also Carl Pacini, Andrew Greinke, and Sally Gunz, Accountant Liability to Nonclient for Negligence in the United Kingdom, Canada, Australia, and New Zealand, 25 Suffolk Transnat'l L. Rev. 17, 18-20 (2001).

[248] See Ch. Butcher, *op. cit*., p. 70.

contractual[249]; and claims in tort by third parties who are not in any contractual relationship with the company's auditor but who claim damages for losses arising from his reliance on negligently audited financial statement and accounts[250].

Faced with potential liability, auditors have been always anxious to secure some legal advantage to avoid or reduce damages claims, such as the incorporation of auditors in limited liability partnerships, purchasing professional insurance to protect themselves, court relief granted in case of honest and reasonable conduct of auditors, and entering into liability limitation agreement with the audited clients[251].

The European Commission concluded in 2008 that unlimited civil liability for auditors combined with insufficient insurance cover pose major obstacles face the development of the audit profession[252]. Therefore, it recommended the member states to take national appropriate procedures to limit auditors' liability[253]. The Recommendation proposed three ways for limiting auditors' civil liability: a financial cap on damages; a contractual limitation admitted by company's shareholders; or a mechanism for proportionality liability[254]

A “liability limitation agreement” is an agreement which aims to limit the amount of a liability owed by an auditor to its audited company in respect of any negligence, breach of duty or trust, or default, occurring in the course of the accounts' audit, of which the auditor may be

[249] This assumption of liability was objectively considered in the case of *Hedley Byrne & Co. Ltd.vs Heller & Partners Ltd.*, 2 AII ER 575, 1963. See in this regard, B. Hannigan, *op. cit*., p. 402.
[250] An assumption of liability for meeting the three fold "foreseeability, proximity and fairness" was considered in the case of *Caparo Industries plc v Dickman*, 1 AII ER 568, 1990; B. Hannigan, *op. cit*., p. 401.
[251] B. Hannigan, *op. cit*., p. 408.
[252] For more details about the regime of liability introduced by the European Commission, see P. Giudici, Auditors' Multi-Layered Liability Regime, European Business Organization Law Review, December 2012, Vol. 13, Issue 4, p. 502.
[253] European Commission Recommendation of 5 June 2008 concerning the limitation of the civil liability of statutory auditors and audit firms, OJ L 162, 21/6/2008, p. 39. See also article 30 of the EU Audit Directive 2014 which states that "Without prejudice to Member States' civil liability regimes, Member States shall provide for effective, proportionate and dissuasive sanctions in respect of statutory auditors and audit firms, where statutory audits are not carried out in conformity with the provisions adopted in the implementation of this Directive, and, where applicable, Regulation (EU) No 537/2014". See C Flores, New Trends in Auditor Liability, European Business Organization Law Review, September 2011, Vol. 12, Issue 3, p. .
[254] See the details of these mechanisms in P. Giudici, *op. cit.,* p. 518-522; C Flores, *op. cit.*, p. 426.

guilty in relation to the company[255]. It is irrelevant how a liability limitation agreement is framed, in sum of money, formula…[256]

The liability limitation agreement should not apply in respect of acts or omissions occurring in the course of the accounts' audit for more than one specified financial year[257]. The Secretary of State may require to include or prohibit from including in this agreement some specified provisions or descriptions[258].

A liability limitation agreement should be authorized by the company's members and this authorization should not be withdrawn[259]. In the case of a private company the agreement should be authorized by a company resolution. A public company needs to authorize this agreement by passing a resolution in a general meeting. The given authorization may be withdrawn by the company passing an ordinary resolution to that effect at any time before entering the agreement, or, if the company has already entered into the agreement, before the beginning of the specified financial year[260].

However, auditor cannot limit its liability in an unreasonable way[261]. A liability limitation agreement is not effective to limit the liability of the auditor to less than a fair and reasonable amount taking into consideration the responsibility of the auditor, the nature and purpose of the contractual obligation of the auditor, and the professional standards expected of him[262]. An agreement that purports to limit the liability of the auditor to less than a fair and reasonable amount shall have effect as if it limited his liability to that amount. In determining

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[255] S. 534-1 CA 2006. P. E. Morris, Contractual Limitations on the Auditor's Liability: An Uneasy Combination of Law and Accounting, Modern Law Review, July 2009 - Volume 72, Issue 4, p. 607; See also regarding the "Agreements to cap liability", Ch. Butcher, *op. cit*., p. 75.
[256] *Id*. 534-4.
[257] *Id.* S. 535-1.
[258] *Id.* S. 535-2.
[259] P. E. Morris, *op. cit*., p. 616.
[260] *Id.* S. 536-1,2,3 & 5.
[261] P. E. Morris, *op. cit*., p. 624.
[262] See W. Doralt et al., Auditors' Liability and its Impact on the European Financial Markets, The Cambridge Law Journal, March 2008 - Volume 67, Issue 1, p. 68.

the fairness and reasonability of the amount no account is to be taken of issues incurred after the loss or damage in question, Or issues, whenever arising, affecting the possibility of recovering compensation from any person liable for the same damage or loss[263].

Eventually, a company which enters into a liability limitation agreement must disclose the provisions of this agreement as the Secretary of State may require by regulations[264].

3. The United States Perspective

A discussion of the Jordanian auditor would not be complete without including and potentially incorporating the sweeping transformations in audits since 2002 heralded by the Sarbanes Oxley ("SOX") law. Enron imploded the following month, prompting the passage of the Sarbanes-Oxley regulations in the United States. Six years later, the financial world collapsed, leading to the adoption of the Dodd-Frank regulations and a global initiative to reconcile differences between U.S. and international accounting regimes.

Proper auditing and financial reporting is an integral component of U.S. corporate governance and a strong incentive to attract investment capital. Investors, banks, regulators and other parties who deal with the reporting entity rely upon accurate financial reporting and high quality audits. As noted by the U.S., Supreme Court:

> The SEC requires the filing of audited financial statements in order to obviate the fear of loss from reliance on inaccurate information, thereby encouraging public investment in the Nation's industries.

In the aftermath of the spectacular falls of major U.S. companies such as Enron and WorldCom, SOX was passed in 2002 which imposed significant changes on U.S. public companies and auditors; shifting primary responsibility from management to audit committees

[263] *Id*. S. 537-1.2 & 3.
[264] *Id*. S. 538.

obligating reporting companies and auditors to make assertions regarding internal control mechanisms and the audit. SOX also established the Public Company Accounting Oversight Board (PCAOB) charged with monitoring auditors of public companies. Academics and the private sectors have divergent opinions on SOX's success and particularly given the financial scandals involving banks in recent years[265] it is undeniable that SOX cannot prevent financial reporting fraud.[266] However, SOX is generally conceded even by critics as having improved corporate governance and reducing corporate fraud.[267] Therefore, we believe Jordan can benefit from incorporating several SOX components.

Among the main features of SOX was the formation of the PCAOB[268] which was established to oversee the audits of public companies in order to protect investors and enhance public confidence in the independent audit process. The PCAOB bears responsibility to regulate and monitor – and if needed to discipline - accounting firms in their roles as auditors of public companies.[269] Accounting firms that prepare or issue audits for a public company (or

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[265] Joel Slawotsky, Reining in Recidivist Finanical Insititutions, 40 delaware Journal of Corporate Law 280 (2015 (noting the many banks and investment houses that repeatedly violate the law)

[266] H. David Sherman and S. David Young, Where Financial Reporting Still falls Short https://hbr.org/2016/07/where-financial-reporting-still-falls-short ("First, corporate financial statements necessarily depend on estimates and judgment calls that can be widely off the mark, even when made in good faith. Second, standard financial metrics intended to enable comparisons between companies may not be the most accurate way to judge the value of any particular company—this is especially the case for innovative firms in fast-moving economies—giving rise to unofficial measures that come with their own problems. Finally, managers and executives routinely encounter strong incentives to deliberately inject error into financial statements.")

[267] Srinivasan, Suraj, and John C. Coates IV. "SOX after Ten Years: A Multidisciplinary Review." *Accounting Horizons* 28, no. 3 (September 2014): 627–671 ("We report survey findings from informed parties that suggest that the Act has produced financial reporting benefits. While the direct costs of the Act were substantial and fell disproportionately on smaller companies, costs have fallen over time and in response to changes in its implementation."

[268] www.pcaobus.org

[269] This role can be compromised as recently reported. See Steve Burkholder, U.S. Audit Overseer Mulls Safeguards on KPMG Leak Scandal, https://www.bna.com/us-audit-overseer-n57982086774/ April 17, 2017 ("The Public Company Accounting Oversight Board is working to prevent future breaches of conduct that tipped off KPMG LLP about audit inspections and led to the firing of six employees of the firm, including its chief U.S. auditor. Confidentiality is a hallmark of annual inspections of audit firms. That apparently was broken in the KPMG episode, according to the board and the Big Four firm.")

are substantially involved in the audit preparation), are obligated to register with the PCAOB and follow specific rules and guidelines.

Jordan could benefit from establishing a similar auditor oversight board which would oversee the audits of large publicly-traded companies. The board would establish standards and rules for audits and auditors[270] and would obligate all accounting firms that audit public companies to register with the board. The board would also perform inspections and enforce compliance with these registered firms.

Another important aspect of SOX is increased auditor independence listing the non-audit services auditors are prohibited from engaging in with audit clients. Jordan would benefit from forming a list of non-audit services that are off-limits to auditors. SOX also imposed a one year moratorium for auditors to serve as executives in a company their firm audited and a one year freeze before the auditor performs services for the new employer. It would be beneficial for Jordan to consider this as well.

An important tool of deterrence is SOX's imposition of severe criminal penalties for the alteration, destruction or falsification of records and documents with the intent to influence a Federal investigation. Jordan would benefit from a stricter regime of criminal sanction for destroying/falsifying evidence.

Reporting internally and if necessary to outside regulators is of increasing importance in U.S. corporate governance. Jordan should consider encouraging the internal reporting by auditors of public companies. The paradigm is not to immediately disclose to regulators but rather a duty to report internally to the CEO and/or audit committee. However, if internal

[270] Such standards could include for example, in addition to passing minimum academic credentials and work experience, passing a special examination on business ethics, and continuing professional education each year.

reporting fails, the trend is now to establish strong incentive for reporting wrongdoing and protecting whistleblowers including auditors.

> Provisions of Sarbanes-Oxley and the Exchange Act mandate internal reporting before external reporting. Auditors, for example, must "as soon as practicable, inform the appropriate level of management" of illegal acts, and only after such internal reporting may auditors bring their concerns to the SEC. 15 U.S.C. § 78j-1(b). Leaving employees without protection for that required preliminary step would result in early retaliation before the information could reach the regulators. As the Second Circuit noted, "[I]f subdivision (iii) requires reporting to the [SEC], its express cross-reference to the provisions of Sarbanes-Oxley would afford an auditor almost no Dodd-Frank protection for retaliation because the auditor must await a company response to internal reporting before reporting to the Commission, and any retaliation would almost always precede Commission reporting.[271]

Jordanian audits would be strengthened if auditors were charged with reporting to the CEO and audit committee any dereliction of duties with respect to audits and financial reporting. The regime would also be greatly incentivized if auditors were allowed to collect a percentage of a penalty and be protected from reporting.

> As a key part of its safeguards, Sarbanes-Oxley requires internal reporting by lawyers working for public companies. []. This is in addition to internal reporting by auditors, which was already mandated by the Exchange Act. *See* 15 U.S.C. § 78j-1(b). Further, Sarbanes-Oxley requires that companies maintain internal compliance systems that include procedures for employees to anonymously report concerns about accounting or auditing matters. *See* 15 U.S.C. § 78-j-1(m)(4), 7262. It also provides protections to these and other "whistleblower" employees in the event that companies retaliate against

[271] See SOMERS, v. DIGITAL REALTY TRUST INC. 9th Circuit 2017 quoting *Berman,* 801 F.3d at 151

them. 18 U.S.C. § 1514A(a). Sarbanes-Oxley expressly protects those who lawfully provide information to federal agencies, Congress, or "a person with supervisory authority over the employee."[272]

Based upon the improvements in U.S. auditing, we recommend that Jordan incorporate the spirit of whistleblowing for auditors as an incentive to ensure a high level of governance and reduce the risk of false financial reporting.

VI. CONCLUSION

Superior corporate governance forms the bedrock of a prosperous economy. In parallel, an economy may be derailed by allowing management to continue to mismanage the corporate sector through accounting “accounting irregularities” and will scare off foreign investors and an economy will decline."[273]

An integral component of outstanding corporate governance is the role of transparent, accurate and freely available information with respect to a company’s books and records. Numerous stakeholders including current and potential investors, business partners, employees, regulators and the public, rely on the integrity of the financial reporting. Thus, the vital role of the external auditor in vetting financial statements cannot be understated.

As described in this article, the law on external auditors in Jordan has undergone significant improvement, yet substantial gaps exist between current law and best practices. We have delineated certain aspects that should be updated. The recent experience of the United States reform of auditors provides some concrete suggestions that would benefit the improvement of auditing in Jordan.

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[272] See SOMERS, v. DIGITAL REALTY TRUST INC. 9th Circuit 2017

[273] http://www.barrons.com/articles/japans-corporate-governance-woes-1445665396 (“foreign investors flocked to Japan earlier this year and then just as quickly exited in the past few months.").

CAN CORPORATE TRAINING IMPROVE SOCIAL JUSTICE?

by Brien C. Walton* and Arvyce O'Toole**

I. INTRODUCTION

Leadership ability may be the most important character trait that a company looks for in a new employee, and many corporations spend millions of dollars in their efforts to train employees to become more effective organizational leaders. There are some leadership theorists that believe that people must be born leaders, whereas other leadership theorists believe that leadership can be taught, *e.g., leadership can be nurtured and developed over time*. We assert that nurturing is the key to developing great managers as well as socially aware employees.

Leadership development is the essence of corporate training, which means those corporations spending millions of dollars to nurture future leaders tend to fall in the latter group. Since the murder of George Floyd, Jr. on May 25, 2020, in Minneapolis, MN,[1] there has been a growing social justice movement that has caused corporations to consider if they can also teach employees how to be more socially aware. The motivation behind those corporate initiatives is not always altruistic, however, because with growing awareness of social injustice comes growing awareness of social injustice in the workplace. Commensurate with that awareness is the potential legal liability when employees learn to recognize that some of the "watercooler banter" is racially insensitive, misogynistic, or perpetuating religious tropes.

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[1] A&E Television Networks. (May 24, 2021). *George Floyd is killed by a police officer, igniting historic protests*. History.com. Retrieved from https://www.history.com/this-day-in-history/george-floyd-killed-by-police-officer.

Despite the steadily increasing number of social justice initiatives, people of color's advancement, particularly in the workplace and local government administration, continues to be stagnant. Human resource managers, executive recruiters, and trade associations struggle to find "qualified" minorities to lead large-scale projects, businesses, or agencies but often overlook potential talent that may already be in-house. This article explores how corporate training has evolved since 2020 and the potential impact on employee lawsuits regarding hostile work environments experienced by federally designated protected classes.

II. EVOLUTION OF THE PROTECTED CLASS

The current protected classes of employees are generally defined by race, color, religion, sexual orientation, gender identity, national origin, age (40 and older), and disability. 200 years ago, however, the mere mention of a "protected class" would have been laughable, at best, and possibly result in the mentioner's death, at worst. The Civil Rights Act of 1866, which is codified at 42 U.S.C. § 1981, essentially prohibits discrimination based on "…race, color, or previous condition of servitude." [2] Section 1981(a) of the Act then barred discrimination in the making of contracts based on race and color, which is commonly understood to include employment contracts.[3]

Protected classes made a substantial leap with the passage of Title VII of the Civil Rights Act of 1964, which is codified at 42 U.S.C. §§ 2000e *et seq*., and expanded the prohibition on discrimination to the basis of national origin, sex, and religion.[4] Also relevant to employment is the fact that Title VII created the Equal Employment

[2] 42 U.S.C. § 1981 - Civil Rights Act of 1866.
[3] *Id.*
[4] 42 U.S.C. §§ 2000e et seq. - Civil Rights Act of 1964, Title VII.

Opportunity Commission ("EEOC"), which is the independent federal agency that oversees the enforcement of all civil rights pertaining to employment.[5] Soon after Title VII came the Age Discrimination in Employment Act of 1967 ("ADEA"), codified at 29 U.S.C. §§ 621–634.[6] This was the legislation designed to combat "ageism" by protecting employees aged 40 and older.[7] Protection of those with disabilities came fully into application with the 1990 passage of the Americans with Disabilities Act ("ADA"), codified at 42 U.S.C. § 12101.[8]

III. CORPORATE TRAINING: DEVELOPING PEOPLE SKILLS THROUGH SELF-AWARENESS

A. If you are not self-aware, you cannot recognize that you are not self-aware

Corporate training is an important topic in that it can impact the personal and professional worlds of employees. For example, a person who is popular and successful at work tends to be socially adept in his or her personal life as well, so there is often a "cross-over" in behaviors and ideas. According to Dan Goleman (1995), self-awareness of your behavior and ideas requires the ability to understand emotions and do proper self-assessment.[9] As a result, self-awareness requires being present at the moment, recognizing your feelings, then leveraging the most appropriate emotions relevant to your situation to guide decision-making. These are critical steps in how employers and employees can begin the process of recognizing the protected classes in their work environment, and their respective behaviors or the behavior of others may be perceived by members of protected classes.

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[5] *Id.*
[6] 29 U.S.C. §§ 621–634 - Age Discrimination in Employment Act of 1967.
[7] *Id.*
[8] 42 U.S.C. § 12101 - Americans with Disabilities Act of 1990.
[9] Goleman, D. (1995), Emotional Intelligence. New York: Bantam.

Inherent in this process is taking the time to conduct a realistic assessment of your abilities and having the confidence to make any necessary changes. For example, a racist may not be aware that their beliefs and attitudes are "racist" if they are not aware of how those characteristics manifest in someone's personality. Ironically, it often requires having empathy or at least being exposed to a different point of view that enables a person to realize how their views may be divergent from the norm. Empathy entails understanding what individuals feel, the ability to consider the views of others, and developing rapport and coordination with different humans to enhance group work (in work and organizational environments).[10] Developing rapport and adequate social skills enables a person to persuade and lead, negotiate and settle disputes, and inspire cooperation and teamwork. In our experience, developing those two abilities is often essential to long-term business success because they have a synergistic effect that intertwines throughout all aspects of business operations.

B. Leveraging "self-awareness" into good business leadership

Akbari & Safarnia (2012) interpret five competencies in the context of leadership as corresponding to the essential domains of self-awareness and management, as well as social awareness, each of which is an important factor in business success.[11] For example, their research covers "self-awareness," which has a subset of leadership-related competencies that distinguish between the accuracy of our self-assessments and the impact on self-esteem.[12] The domain of self-awareness requires a deep understanding of our emotional makeup including our respective value systems, internal motivation, and

[10] *Id.*
[11] Akbari, Z., & Safarnia, H. (2012). *The relationship of emotional intelligence, market orientation and competitive strategy.* Interdisciplinary Journal of Contemporary Research in Business, 4(8), 497-511. Retrieved from http://search.proquest.com/docview/1282292420?accountid=35812.
[12] *Id.*

personal strengths and weaknesses. The key point to remember here is the focus on our respective "value system" because that directly impacts how we expect to be treated and how we tend to treat others. As a result, an effective corporate training program that involves reflection on an employee's value system is a key first step in that employee recognizing how their value system is the same or diverse from their friends, their coworkers, and society in general. From that foundation, an astute corporate trainer can integrate real-world examples that compare and contrast moral and ethical value systems that will help employees navigate the subsequent steps in developing self-awareness.

The second domain of "self-management," which has a subset of competencies reflecting self-regulation, transparency/integrity, adaptability, achievement orientation, and optimism, reflects our ongoing efforts to effectively manage disruptive emotions and impulses.[13] Self-control is observable when viewing a person who remains calm, but alert, during a crisis, or other stressful situation. In contrast, integrity is a social competency that reflects being authentic and genuine about our beliefs, feelings, and actions, when dealing with others.[14] Similar to the attributes of integrity, the competency of "adaptability" reflects our ability to recognize new challenges and employ intellectual and emotional resources to resolve those challenges.[15] From a leadership perspective, an adaptable leader is comfortable with the inevitable ambiguities of organizational life and navigating complex interpersonal relationships in light of the social justice movement because they are more flexible in their thinking when they encounter new data or situations. The "achievement orientation" subset of self-management is an important attribute to consider because it reflects a person's initiative and drive to succeed, e.g.,

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[13] *Id.*
[14] *Id.*
[15] *Id.*

their personal standards and motivation to improve themselves and those around them.[16] The final subset of "optimism" is also an important competency related to adaptability because an optimistic leader can see an opportunity, where others may see a threat or setback.[17] In addition, their positive outlook can influence and motivate people around them.

Akbari & Safarnia (2012) interpret the third domain of "social awareness," as having competencies reflecting "empathy," "organizational awareness," and "service orientation."[18] Empathy is key competency because it reflects how attuned a person is to the various emotional signals displayed by others - both verbal and non-verbal. Empathetic leaders usually have the patience to listen attentively and understand the perspective of others, even if they do not share the same perspective. Socially, empathy makes it possible for people to easily interact with others from diverse backgrounds.

IV. CORPORATIONS CAN HELP EMPLOYEES BECOME BETTER SOCIAL CITIZENS THROUGH SITUATIONAL AWARENESS

A. How do business leaders handle problems?

A dominant framework used in interpreting business strategy is Miles & Snow's (1978) framework, which uses the contexts of entrepreneurial, engineering, and administrative problems to group businesses into defenders, prospectors, analyzers, and reactors.[19] According to Miles & Snow, the ability to locate and exploit new markets is the distinguishing attribute of Prospectors, whereas Defenders usually take the approach

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[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] Miles, R.E. & Snow C.C. (1978). *Organizational, Strategy, Structure, and Process*. McGraw-Hill, New York, NY.

of establishing a niche market to ensure the stability of vendors and customers.[20] In the middle are Analyzers, who may model the success of Prospectors by expanding into new markets, but only after having established a stable niche.[21] In contrast, the Reactor usually has an unpredictable response to an entrepreneurial problem, which can reflect a lack of business stability and unsustainable growth.[22]

With regard to business organizations trying to manage the lack of business stability and unsustainable growth, Berger (1999) identifies three key challenges that business leaders encounter. Those challenges include:

1. An increasing requirement to work effectively in groups and there is increasing diversity of every kind in the workplace. Management in addition to market conditions can impose this demand.
2. An increasing demand for people to be more productive, to understand more, to learn faster, and to take charge of more of their own decisions. Management to increase profitable operations can impose this demand.
3. A trend of decreasing loyalty to the workforce by the leaders of organizations, less job security for everyone, and less likelihood that anyone will work for the same company for an entire career. This challenge can be created by company policies in addition to market conditions.[23]

Berger (1999, p. 16) also concluded that coaching "is an excellent response to the challenges of modern life in an organization."[24] In other words, both approaches see the

[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] Berger, J. (1999). "Key Concepts for Understanding Kegan's Constructive-Developmental Theory." Unpublished notes.
[24] *Id.*

need for support systems to be in place to address the challenges faced by business leaders. In addition, the first three competencies (self-awareness, self-regulation, and motivation) reflect self-management skills, e.g., regulation of ourselves. The remaining two competencies (empathy and social skills) reflect our ability to manage relationships with others.

Goleman's (2006) insights into challenges faced by business leaders are consistent with Berger, and Goleman has concluded that teams in the work environment are becoming increasingly important and even though all competencies are required of a business leader, the competency of empathy is especially important for business leaders today.[25] His rationale for the importance of empathy is that it helps leaders meet the challenges of understanding his or her team's emotions and it can help minimize misunderstandings between parties in a global work environment.[26] Most important is that empathy enables a leader to be a better mentor (coach) to employees, which leads to increased job satisfaction and employee retention, and better long-term performance.[27] From our perspective, this improved ability to mentor employees by leveraging self-awareness, empathy, and other socio-behavioral competencies reflects a clear path toward improving social justice, at least in the workplace. As noted earlier, because work and home lives are intrinsically intertwined, then it is reasonable to assume that social justice-friendly training initiatives at work can lead to social justice-friendly behavior at home and in the community.

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[25] Goleman, D. (2006). Social Intelligence. The New Science of Human Relationships. New York: Bantam.
[26] *Id.*
[27] *Id.*

V. WHERE DO WE GO FROM HERE?

The corporate training environment can present some challenges when integrating themes that can challenge a person's view of the world or contradict deep-rooted beliefs tied to race, religion, gender roles, and capabilities. According to Echard and Berge (2008), who have studied effective training techniques that specifically produce results in customer service, product development, and business analytical skills, it is possible to establish a benchmark training system, which incorporates best practice methods and creates a corporate culture sensitive to new business opportunities.[28]

In developing a socially aware training course for a company, a good model to follow may be integrating Scardamalia and Bereiter's (1993) view of a knowledge-building classroom, where each participant from a diverse background can contribute to the collective knowledge base of all participants.[29] To accomplish that objective the trainer can carefully phrase open-ended discussion questions that will allow recounting specific experiences reflecting the diverse backgrounds of the employees, but enable the employee to withhold any details that identify the names of people involved or withhold locations or other factors that could impinge on the privacy of others. Departments usually have unique issues inherent to their business practices, which can allow each participant to receive acknowledgment for an insight that may approach a similar problem from diverse perspectives.

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[28] Echard, R., & Berge, Z. (2008, July). *Quality Management Builds Solid Etraining*. Turkish Online Journal of Distance Education (TOJDE), 9(3), 12-18. Retrieved from Education Research Complete database.

[29] Scardamalia, M. and Bereiter, C. (May 1993) *Technologies for knowledge-building discourse*. Communications of the ACM, 36.n5: 37(5). Retrieved from Gale General OneFile database.

Combined with a proactive effort from top management down to front-line workers, we believe it is possible to facilitate socially-conscious collaboration, intentionally engage diverse groups in productive interaction, and ideally – provide employees the socio-behavioral tools required to help other people in their sphere of influence become a little more aware of, and accepting of, the diversity in their communities. Although it seems possible for corporate training to improve social justice by at least making employees aware of protected classes and who is considered "diverse", the real challenge is incentivizing companies to take that critical step of recognizing the benefit, not just to their employee, but also their customers, which can take the concept of being a "socially responsible" company to a much higher level.