

**THE EFFECT OF THE SPANISH FINANCIAL ACT (44/2002) ON THE AUDIT QUALITY AND
THE EARNINGS MANAGEMENT PRACTICES**

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This Draft: April 2008

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Area temática: a) Financial Reporting.

Palabras-clave: audit quality, earning management, audit enforcement rules and actions, Financial Act (44/2002) and oversight in the European Union.

Idioma : English or Spanish.

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The authors appreciate funding from the European Commission Research Training Network INTACCT (Contract MRTN-CT-2006-035850) and from the Ministry of Education and Science of Spain (SEJ2005–08644-C02–02/ECON). The authors are also grateful for helpful comments and suggestions offered by Beatriz Garcia Osma, Patricia Texeira, Begoña Giner, Peter Pope and further members of INTACCT.

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Abstract

This study examines the effect of the Financial Act (44/2002) on the audit quality in Spain in order to provide empirical evidence on whether the new enforcement rules and actions recommended by the EU and introduced under the FA really results in higher audit quality. Under the FA, new enforcement rules and actions are implemented with the goal of increasing the probability of audit failures being detected and auditors punished and consequently increasing incentives for auditors to supply audit quality. The public oversight body for the audit profession (the Institute of Accounting and Auditing – ICAC) and the main audit corporation (the Spanish Institute of Chartered Accountants- ICJCE) defend that the legal changes implemented under the FA are successful to secure and increase the audit quality (Fernández 2001; Fernández 2002; Atarés and Canales 2004). However there is no empirical test that supports their opinions. Using data for the pre- and post-FA periods 2000-2001 and 2003-2004 from the Spanish companies we attempt to empirically test the effect of the FA on audit quality by assessing the capacity of auditors to constrain opportunistic earnings management practices. The results of this study find evidence that the Spanish auditors supply higher audit quality after the FA. Additionally we find evidence that the effect of the FA on audit quality is stronger on big four auditors than on non-big four auditors.