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Reactions of the Spanish capital market to qualified audit reports

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Abstract

Since mandatory auditing of financial statements was first established in Spain, very few studies have been conducted to test the information content of audit reports in the Spanish capital market. The aim of this study is, then, to test empirically whether there is a relationship between audit qualifications and stock prices in the context of the Spanish market. We have used the event study methodology for this purpose. Our findings show that qualified audit reports do not have information value for investors.

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Notes

Soltani (2000) used this event date in the French capital market. His results revealed that some qualifications had information content fifteen days before the AGM was held. In common with Spanish legislation, French company law requires that the audit report and the financial statements be made available at least fifteen days before the AGM is held. France and Spain both belong to the continental European legal tradition, which explains why their companies legislation is similar, but differs from that of the English-speaking countries.

To establish the date on which the AGM of shareholders of each of the companies comprising our sample was held, it was necessary to resort to the Official Bulletins of the Companies Registry (BORME). Regarding the date when the CNMV put the audit report at the disposal of the public, we used a computerized register obtained from the CNMV to establish the date at which the stock market regulator made the audit report available to the public.

The event window, or period during which we examine the abnormal returns of the target companies, should include the day on which users first had knowledge of the opinion contained in the audit report (i.e. the event date). For the purposes of this study, we have used daily share price quotations over a period of twenty-five days, which constitutes the duration of our event window. The actual day of the event falls in the middle of the window, and we consider the twelve following days to determine whether the fact of the occurrence of the event provoked any change in the share price. We also consider the twelve days preceding the event to study whether the market was able to anticipate the content of the qualified audit report by other mechanisms prior to its actual occurrence. Given results may be sensitive to the length of the event window used; we have also used three alternative event windows: [−1, +1], [−3, +3] and [−7, +7].

The daily price quotations of the shares were obtained from the Sequencer database. For the dividends earned on shares, we consulted either the CNMV website or company reports. These data were used to compile a database in accordance with our needs.

One of the principal limitations of this model is poor specification, while it is relatively inaccurate when daily price quotations are utilized. On the latter point, certain studies indicate that the estimated parameters of the market model applying the ordinary least squares (OLS) method will be inconsistent and biased if daily quotations are used due to infrequent trading in some of the stocks (see, among others, Scholes and Williams, 1977; Dimson, 1979). These studies report that the estimation of the beta of quoted shares that are more frequently traded will be overstated, while that of less frequently traded stocks will be understated. In this context, the empirical literature proposes various models intended to improve the estimation of the parameters. Among these are the beta models of Scholes and Williams (1977) and of Dimson (1979). Nevertheless, subsequent studies such as those of Brown and Warner (1980, 1985) and Jain (1986) have confirmed by empirical testing that the Scholes–Williams and Dimson models fail significantly to remove the bias in the parameters estimated by OLS. In short, though some studies have tried to design more accurate models to deal with the problem of non-simultaneous trading, the models proposed do not provide any substantially better results than the market model.

In accordance with Spanish auditing law, going-concern problems are treated as an uncertainty. Where they exist, therefore, the auditor is obliged to express a qualified opinion or, if the problem is acute, to issue a disclaimer of opinion.

We calculated the mean of companies for which we used the CNMV date and the fifteen days prior to the AGM date. The CNMV date was used for 62% of total companies qualified from 1992 to 1995. We used the fifteen days prior to the AGM date for the remaining 38% of companies.

Source: Academy of Management Journal
STUDIES OF THE INFORMATION CONTENT OF QUALIFIED AUDIT REPORTS
Source: Journal of Business Finance & Accounting
Abnormal stock returns associated with media disclosures of 'subject to' qualified audit opinions
Source: Journal of Accounting and Economics
Efficient Capital Markets: A Review of Theory and Empirical Work
Source: The Journal of Finance
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