

RACE TO BELL THE CAT: A COMPARATIVE ANALYSIS OF SPANISH AND UNITED STATES' AUDIT REGULATORY FRAMEWORKS

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Abstract

Audit regulatory frameworks are responsible for establishing the standards and practices that govern auditing processes, ensuring accuracy, transparency, and accountability. Spain and the United States have distinct regulatory structures shaped by unique legal traditions and economic environments. Employing the doctrinal methodology, this study compares the audit regulatory frameworks of the United States and Spain. It first examines the history of audit regulation in both countries. It analyses the reach of the regulatory era initiated by the United States in the wake of the fall of Enron and its influence on Spain. With the internationalization of capital markets and audit practice understanding of auditor's liability beyond our national boundaries is now a lawyer's business imperative. This study found that formal audit regulation in Spain predates the US and recommends comprehension of law across national boundaries.

Keywords: Auditors, Audit regulation, Sarbanes-Oxley Act, Spanish Audit Law

1.0 Introduction

It is reasonable to dedicate a few lines to the function of audit in business financing to help understand the subject. The following paragraphs will do just that, looking at the role and function of auditors in the financial markets and then proceeding to how auditing is organized and

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conducted in these two legal systems. An audit therefore is a systematic and objective examination of a company's financial statements which results in an opinion expressed by the auditor.¹ The paper examines the roles of auditors in corporate governance and audit regulations in US and Spain.

2.0 The Role of Auditors in Corporate Governance

The content of auditor's duties and accounting services offered to clients vary from the jurisdictions under consideration. However, the core function of auditors common to both systems is to perform an audit and express an opinion on the "fairness" of a company's financial statements.² The auditor's opinion must state whether the financial statements fairly present the economic position and results of operations consistent with generally accepted accounting principles.³ The substance of auditing is seen in the fact that an enterprise seeking financing through loans, stock offerings, and other forms of credit enhancement invariably, looks to investors and creditors.⁴ Creditors and investors, in turn, look to the enterprise's financial audit in making lending and investing decisions.⁵ Auditors in essence provide third parties with assurances and external and objective checks on the way financial statements are prepared and presented.⁶

¹ John K Grubbs and James R Ethridge Jr, 'Auditor Negligence Liability to Third Parties Revisited' (2007) 10(1) *Journal of Legal, Ethical and Regulatory Issues* 75, 76, citing Impastato, *Legal Liability in Auditing* (Routledge 2003)

² Randall S Panttaja, 'Accountants' Duty to Third Parties: A Search for a Fair Doctrine of Liability' (1994) 23 *Stetson Law Review* 927, 932, citing American Institute of Certified Public Accountants, *Codification of Statements on Auditing Standards* (AICPA 1990).

³ *ibid.*

⁴ Jodi B Scherl, 'Evolution of Auditor Liability to Noncontractual Third Parties: Balancing the Equities and Weighing the Consequences' (1994) 44(1) *American University Law Review* 255

⁵ *ibid.*

⁶ Cadbury Report (Committee on the Financial Aspects of Corporate Governance, 1992) para 5.1

Auditors frequently point out in debates about liability, that the company, not the accountant, prepares the financial statements.⁷ Nonetheless, it is their function to evaluate the assertions made by the management, and validate and give credibility to those assertions. If they issue a clean audit, indicating a healthy enterprise, investors and creditors are often willing to provide credit or needed capital.⁸ Moreover, investors and creditors are invariably attracted to an enterprise based on its financial stability, certified by the audit. As noted by Impastato, “this validation (by the auditor) is meant to make the financial information reliable; therein lies the value of auditing”.⁹

Apart from the useful information it provides to the management of a company about the effectiveness of its internal accounting system and the accuracy of information the system produces, the audit also provides third parties with an independent evaluation of the company’s financial statements and the process that produced them. As such audit can be said to serve two purposes: first, it provides the directors and officers of the company with reasonable assurance in making managerial decisions, helps potential investors to evaluate the financial state of the company, and makes investment decisions on the strength of it.¹⁰ Second, and critically the auditor’s validation is essential to third parties who might rely on the company’s financial reports in making financial decisions. Invariably, prospective shareholders, investors, lenders, sureties and public authorities have a substantial interest in the auditor’s work, often being the only independent and objective source of information available to them.¹¹

3.0 Audit regulation in the US

⁷ Jay M Feinman, ‘Liability of Accountants for Negligent Auditing: Doctrine, Policy, and Ideology’ (2003) 31(1) *Florida State University Law Review* 17, 26

⁸ Scherl, ‘Evolution of Auditor Liability’ (n 4) 257, referred to the definition by Hagen, W. W. II (1987), (audit as the independent inquiry made by an accountant into how fairly an entity’s financial statements reflect its actual financial position).

⁹ Grubbs and Ethridge Jr, (n 7).

¹⁰ Lara Khoury, ‘The Liability of Auditors Beyond Their Clients: A Comparative Study’ (2001) 46 *McGill Law Journal* 413, 417.

¹¹ *ibid* 418.

The regulation of auditing under US corporate law consists of both federal and state legislation. The power to regulate any activity directly or indirectly related to interstate commerce is constitutionally vested in the US Congress.¹² 'As a corollary, each state has the implied right to legislate on such interstate commercial activity that has been left unregulated by the congress.'¹³ Simply put, American corporate law consists of two 'parallel and interlocking systems' of state corporate law which regulates the internal affairs of corporations and federal law which establishes a national policy for the securities markets.¹⁴ The division of authority envisaged between federal and state officials is nonetheless, not sacrosanct. According to Jones, 'the tradition of respect for state authority in securities regulation has significantly eroded', as the U.S. Congress had increasingly intervened whenever necessary to decisively remedy a problem traditionally left to state law.¹⁵ One such situation was the promulgation of the Securities Act of 1933.

3.1 Securities Act of 1933

Arguably, crisis and regulation are not strange bedfellows, especially in the financial industry.¹⁶ Indeed the 1933 Securities Act was brought about as a legislative response to a deep financial crisis that gripped the US economy following the stock market crash of 1929.¹⁷ The Dow Jones Industrial Average lost most of its value with many investors losing their fortunes, a dire economic situation that ushered in the Great

¹² Article 1 section 8 of the United States Constitution.

¹³ Helen Drake, 'The Legal Regulation of the External Company Auditor in Post-Enron South Africa' (Master of Laws thesis, University of Stellenbosch 2009), 17 <[scholar.sun.ac.za/bitstream/.../Drake, %20H.pdf](http://scholar.sun.ac.za/bitstream/.../Drake,%20H.pdf)> accessed 12 September 2024

¹⁴ Renee M Jones, 'Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate' (2006) 41(3) *Wake Forest Law Review* 879, 889 http://works.bepress.com/renee_jones/9 accessed 27 September 2024

¹⁵ *ibid.*

¹⁶ *ibid* 887. Jones argues that long before the recent financial crisis, the U.S. Congress had been engaged in 'conduct regulation' through statutes like The Williams Act of 1968 and The Foreign Corrupt Practices Act of 1977.

¹⁷ James Wegman, 'Government Regulation of Accountants: The PCAOB Enforcement Process' (2008) 11(1) *Journal of Legal, Ethical and Regulatory Issues*

Depression.¹⁸ The crash was essentially caused by greed manifested in fraud and manipulation of securities. Understandably, the public cried out for reform. To be seen as actively addressing the causes of the terrible economic depression gripping the nation,¹⁹ the US Congress responded by passing the Acts of 1933 and 1934. The Acts imposed new financial reporting and disclosure requirements and prohibited certain practices, such as insider trading.²⁰ The Acts also made auditing of public companies in the United States obligatory²¹ and placed its administration under the Securities and Exchange Commission.²²

3.2 Securities and Exchange Commission (SEC)

The SEC was established under the Securities Exchange Act of 1934 to act as the central authority responsible for oversight and discipline of the accounting profession, as well as forming and adapting accounting and auditing standards.²³ This authority was however sparingly employed by the SEC preferring instead to delegate the function to self-regulation of the accounting profession's principal trade association, the American Institute of Certified Public Accountants (AICPA) and other non-governmental organizations like the Financial Accounting Standards Board (FASB) and Independence Standards Board (ISB).²⁴ The AICPA on the other hand established the Public Oversight Board (POB) and charged it with overseeing the work of public accountants. However, the POB was unable to effectively undertake this task due to its lack of authority to sanction errant auditors.²⁵ For instance, in a

¹⁸ *ibid.* Here Wegman was citing John K Galbraith, *The Great Crash, 1929* (1st published 1955, revised ed., Mariner Books 1997).

¹⁹ *ibid.*

²⁰ *ibid.*

²¹ Until then auditing public companies was not compulsory and was merely required by some state laws.

²² Securities Act 1933 (SA 1933) s 19 (a). The accounting authority now held by the SEC was held briefly by the Federal Trade Commission until the SEC was created by the Securities Exchange Act 1934 (SEA 1934) s 4 (a).

²³ These standards include the creation of independence standards for auditors.

²⁴ The SEC uses these organizations to create and implement auditing and accounting standards and rules. But it still maintains disciplinary powers.

²⁵ John Wegman, 'Impact of the Sarbanes-Oxley Act on Accountant Liability' (2007) 10(1) *Journal of Legal, Ethical and Regulatory Issues*, 4.

disagreement over the POB's plan to review the BIG FIVE²⁶ accounting firm's compliance with auditors' independence standards, the AICPA cut off funding for the POB. In 2002 the POB voted unanimously to disband for inability to fulfil its mission.²⁷

The AICPA also created the Auditing Standards Board (ASB) to set standards. However, there was dissatisfaction with the work of the ASB members, mostly practising accountants, who were seen to be more protective of their members than serving the public interest.²⁸ As expressed in no equivocal terms by Turner, former SEC Chief Accountant at the Enron Congressional hearings in the following words:

...those standards tend to be written to protect the accounting firms in case they get in trouble on an audit ...it is not drafted with the public interest in mind ... As long as you leave that standards-setting process in the hands of the firms and of the firm's legal counsel, you are going to get standards written to protect them in court, as opposed to standards written to ensure that they do audits that will protect the public.²⁹

In the wake of several high-profile accounting scandals, highlighted by the Enron meltdown and the foregoing testimony, among others, adduced before the congressional hearing, the U.S. Congress concluded that self-regulation by the accounting profession had been inadequate as a model for oversight and standard-setting.³⁰ The need to correct these

²⁶ These were the five largest international accounting firms, responsible for the majority of audits performed on private as well as publicly traded companies, namely, PricewaterhouseCoopers, Deloitte Touch Tohmatsu, Ernst & Young, KPMG and Arthur Andersen in the wake of the Enron debacle. They, however, became the BIG FOUR after the demise of Arthur Andersen in 2002.

²⁷ Wegman, J. (2007, p. 4). Wegman, 'Impact of the Sarbanes-Oxley Act' (n 26).

²⁸ *ibid.*

²⁹ *ibid.* Wegman was citing Senate Committee on Banking, Housing and Urban Affairs, *Accounting Reform and Investor Protection Issues Raised by Enron and Other Public Companies: Hearings before the Senate Committee on Banking, Housing, and Urban Affairs* (2002)

³⁰ *ibid.*

excesses and protect the general public from the abuses of the recent past prompted the passage of the Sarbanes-Oxley Act.

3.3 Sarbanes-Oxley Act

The Sarbanes-Oxley Act, signed into law on 30 July 2002,³¹ represent the most significant and far-reaching regulatory statute on public accounting since the Securities Acts of 1933 and 1934. ‘At its core, the Sarbanes-Oxley legislation was designed to fix auditing problem of US public companies, which is consistent with the official name of the law: The Public Company Accounting Reform and Investor Protection Act of 2002.’³² The impetus to the passage of this law is a matter of common knowledge. A host of high-profile public company bankruptcies, including Enron, WorldCom, and Global Crossing, and a stock market that had dropped precipitously for the previous two years had waned public confidence in the capital markets, public company boards and officers, as well as market regulators. The stunned public demanded action. In response, the Sarbanes-Oxley Act was overwhelmingly passed by Congress to restore public trust and make financial information more reliable.³³ So like its predecessor Acts, the Sarbanes-Oxley Act followed a similar pattern of legislative response to public outrage and a crisis of confidence that threatened the US financial market. The Act is fundamentally meant “to protect investors by improving the accuracy and reliability of corporate disclosures made under securities laws and for other purposes.”³⁴ To achieve this goal and prevent the reoccurrence of the problems that led to corporate failures, the Act seeks to improve the integrity of audits of public companies by removing undue influence on auditors. It requires that audit committees be composed of only independent directors. It also strengthens auditor

³¹ President Bush at the bill signing ceremony referred to the law as “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.” Elizabeth Bumiller, ‘Bush Signs Bill Aimed at Fraud in Corporations’ (31 July 2002) *The New York Times* 1.

³² Coates IV, J. C. (2007, p. 91). John C Coates IV, ‘The Goals and Promise of the Sarbanes-Oxley Act’ (2007) 21(1) *Journal of Economic Perspectives* 91 <http://www.jstor.org/page/info/about/policies/terms.jsp> accessed 15 September 2024

³³ Wegman, ‘Government Regulation of Accountants’ (n 18) 75.

³⁴ Sarbanes-Oxley Act 2002 (SOX 2002).

independence by prohibiting acts that may lead to conflict of interest like performing audit simultaneously with lucrative non-audit work such as consulting.³⁵ Above all it created a new accounting oversight board, the Public Company Accounting Oversight Board.

3.4 Public Company Accounting Oversight Board (PCAOB)

The US Congress dissatisfied with the track record of private self-regulatory bodies was left with no conventional choice than to innovate. That is how it came up with the PCAOB. The financially independent PCAOB is neither a traditional private body nor a public agency. Formally, it is a non-profit corporation with a legal mandate to “oversee the audit of public companies that are subject to the securities laws... to protect the interest of investors and further public interest in the preparation of informative, fair, and independent audit reports”.³⁶ The body functions independently of the US government, and can only be disbanded by an Act of Congress. All audit companies are required to be registered with it if they are to perform audit work and issue audit opinions on US public companies,³⁷ and are subject to the auditing, quality control, and ethics standards adopted by the PCAOB.³⁸

The PCAOB is the first semi-governmental agency created in the US to regulate the accounting profession, which eventually ‘ended the profession’s long-standing tradition of self-regulation and peer review’.³⁹ Although it performs the task usually ascribed to the state organization and is controlled by and reports to the SEC, the PCAOB is not a functionary of the state.⁴⁰ The PCAOB consists of five members who are appointed by the SEC in consultation with other federal

³⁵ cf Wegman, (n 18) 79.

³⁶ SOX 2002, s 101(c).

³⁷ *ibid* s 102.

³⁸ *ibid* s 103.

³⁹ Daniel L Goelzer, ‘Meeting the Challenges of the Changing Global Regulatory Environment’ (Speech, Moores Rowland International Annual Conference, 29 September 2005)

[http://www.pcaobus.org/News_and_Events/Events/2005/Speech/09-](http://www.pcaobus.org/News_and_Events/Events/2005/Speech/09-29_Goelzer.aspx)

[29_Goelzer.aspx](http://www.pcaobus.org/News_and_Events/Events/2005/Speech/09-29_Goelzer.aspx) accessed 14 September 2024

⁴⁰ SOX 2002, s 101.

agencies.⁴¹ These members must be of good reputation and demonstrate commitment and understanding of securities laws and the obligations of accountants with respect to the preparation and issuance of audit reports.⁴² They are to hold office for a once renewable term of five years and may not be removed except for “good cause shown”.⁴³ PCAOB is to be funded directly by public companies rather than by accountants,⁴⁴ to ensure that its members are independent of the accounting profession and less amenable to political pressures.⁴⁵

The main function of the PCAOB is ‘to oversee the auditors of public companies, protect the interests of investors, further the public interest in the preparation of informative, accurate, and independent audit reports’,⁴⁶ and generally, administer the accounting provisions of the Sarbanes-Oxley Act.

To accomplish this task, the PCAOB follows the pattern of its predecessor agencies using hiring experts, promulgating rules, and setting up an enforcement mechanism for those rules.⁴⁷ Other functions of the PCAOB include the registration of public auditing firms,⁴⁸ conducting investigation and disciplinary procedures against any public company that fails to adhere to its rules,⁴⁹ and performing any other functions that may be assigned to it by the SEC. PCAOB is also charged with conducting periodic inspections of registered accounting firms to ensure compliance with its standards.⁵⁰ Its decisions nonetheless, are subject to review by the SEC which constitutes final administrative action from which an adversely affected party may appeal to federal

⁴¹ *ibid.*

⁴² *ibid.*

⁴³ *ibid.*

⁴⁴ According to SOX 2002 109, the PCAOB is to be funded through a levy placed on corporate issuers in proportion to their “equity market capitalization.”

⁴⁵ Wegman, ‘Government Regulation of Accountants’ (n 18) 81.

⁴⁶ SOX 2002, s 101 and Wegman, ‘Government Regulation of Accountants’ (n 40).

⁴⁷ *ibid* s 103.

⁴⁸ *ibid* s 102.

⁴⁹ *ibid* s 105.

⁵⁰ *ibid* s 104.

court.⁵¹ Although PCAOB acts independently of the SEC and manages its own budget, its budget, rules and standards still have to be approved by the SEC before they become effective.⁵²

4.0 Audit regulation in Spain

Accounting regulation in Spain is relatively a new phenomenon.⁵³ Unlike the experience obtained in the US and other industrialized countries, where a long-standing audit tradition became a *sine qua non* for the development of their financial markets and economies, in Spain these conditions were not achieved until well into the 1960s.⁵⁴ In fact, before the Audit Law of 1988, there was no legislation regarding the filing and publication of annual financial statements.⁵⁵ Although auditing was legally required by the 1951 “Ley de Sociedades Anónimas”,⁵⁶ its effect is of little significance. The 1951 law recognized some form of non-mandatory auditing called shareholder auditing “Accionistas Censores de Cuentas.” Under this type of audit, shareholders whose accumulated shares represent ten percent of the company’s capital stock may request an auditor’s appointment.⁵⁷

When so appointed, the auditors would ascertain the reliability of the company’s annual financial statements. However, their capacity to meet that goal has been curtailed by the law itself. The law empowered the directors of a company to block the auditors’ access to financial records when their company’s interest may be jeopardized. Hence the work of the auditors was limited to reviews of the company’s financial

⁵¹ *ibid* s 107.

⁵² *ibid* s 109.

⁵³ Lourdes Cañibano and José Luis Uceda, ‘Accounting and Financial Reporting in Spain’ (2005) <www.uam.es/~pdi/.../canibano_uced_a_2005.pdf> accessed 7 September 2024.

⁵⁴ José Antonio Gonzalo and Juan L Gallizo, *European Financial Reporting* (Routledge/ICAEW 1992) 96, <http://books.google.es/books> accessed 25 September 2024.

⁵⁵ The absence of legislation of such nature then may be attributed to the fact that most private companies in Spain were small and family owned.

⁵⁶ The law covers regulation of public companies.

⁵⁷ *cf* Gonzalo and Gallizo (n 55) 97.

statements, with little investigation of the accuracy and compatibility of the company's supporting records and documentation.⁵⁸

In the early 1980s, the Spanish government embarked on a series of reforms to its financial market aimed at updating Spanish regulations to cope with the fast-growing capital markets activities in the kingdom. These reforms involved enforcing the audits of financial statements of inter alia, state monopolies, regulated industries, such as banks, and utility companies, like electricity.⁵⁹ The enactment of the audit law in 1988 further strengthened these reforms. As noted by Solchaga Catalán, Minister of Economy and Finance as he then was, when presenting the bill:

...el proyecto de ley es cuidadoso, que constituye una pieza fundamental en la modernización de los hábitos financieros, contables y económicos de una sociedad que se está transformando muy rápidamente, como es la española y que, al mismo tiempo, se está abriendo a la economía internacional, con la cual debe compararse en sus ((standard)) de cualidad y de información.⁶⁰

The 1988 audit law⁶¹ based on the EC Directive was a milestone in Spain's commercial and accounting history. It substantially transformed the way audit was organized and practiced in Spain, opened the Spanish economy to the world and brought the world to Spain.⁶² This much was also the conclusion of SALMON as reproduced below:

⁵⁸ María Antonia García Benau and Christopher Humphrey, 'Beyond the Audit Expectations Gap: Learning from the Experiences of Britain and Spain' (1992) 1(2) *European Accounting Review* 303, 306.

⁵⁹ Gonzalo and Gallizo, *European Financial Reporting*, (n 55) 97.

⁶⁰ *Congreso de los Diputados, Diarios de Sesiones* No 84, 11 February 1988, 5361. Spain's House of Representatives records 1988.

⁶¹ This is the main statute that regulates audit in Spain in conjunction with other laws "leyes", rules "reglamentos", royal decrees "reales decretos", orders "ordenes" and resolutions "resoluciones" of the ICAC.

⁶²cf Gonzalo and Gallizo, (n 60).

...the most important structural change in the Spanish economy during the 1980s was the further opening up of the economy to international trade and the avalanche of foreign inward investment occasioned by new legislation and membership of the European Community.⁶³

The Audit Law established a combined system of public and private sector accounting regulation, namely, Instituto de Contabilidad y Auditoría de Cuentas (Institute of Accounting and Audit) and professional auditors' associations.

4.1 Instituto de Contabilidad y Auditoría de Cuentas (ICAC)

The public sector control is exercised by the ICAC,⁶⁴ a body corporate constituted under section 29 LAC. The ICAC as a body is made up of three units, consisting of the chair, auditing committee and accounting board. The chair, who presides over the body, is appointed by the government on the recommendation of the Minister of Economy. Membership of the other units is drawn from a cross-section of stakeholders and experts in the financial industry.⁶⁵

The ICAC acts as the central authority responsible for inter alia, the regulation of accounting, the discipline of the audit profession and the inspection and control of audit quality.⁶⁶ The 1988 law introduced for the first time an Official Auditor's Registry "Registro Oficial de Auditores de Cuentas" (ROAC) and placed it under the management of

⁶³ García Benau and Humphrey, *Beyond the Audit Expectations Gap*, (n 59) 308.

⁶⁴ "Ley de Auditoría de Cuentas 2015", Spanish Audit Law 2015 (LAC 2015) s 1 and 27 and "Real Decreto 2/2021, de 12 de enero, por el que se aprueba el Reglamento de desarrollo de la Ley 22/2015, de 20 de julio, de Auditoría de Cuentas." Spanish Royal Decree 2021 (RAC 2021) s 61.

⁶⁵ LAC 2015, s 29.

⁶⁶ LAC 2015, ss 27 and 28, RAC 2021, ss 61 and 77, as well as Emilio R Barbadillo, Christopher Humphrey, and María Antonia García Benau, 'Auditors versus Third Parties and Others: The Unusual Case of the Spanish Audit Liability "Crisis"' (2000) 5 *Accounting History* 119, 123.

the ICAC.⁶⁷ It made audit of financial statements obligatory for medium and large limited companies⁶⁸ and also ‘laid down a model stipulating the responsibilities of the audit profession’.⁶⁹

The work of ICAC is duly complemented by associations representing auditors referred to as ‘public law bodies representing professional auditors’⁷⁰ by the new law. These are Register of Economist-Auditors “Registro de Economistas Auditores” (REA), General Register of Auditors “Registro General de Auditores” (REGA) and Spanish Institute of Chartered Accountants “Instituto de Auditores-Censores Jurados de Cuentas de España” (IACJCE). The Audit Law embraced these associations by recognizing them;⁷¹ in fact many of the powers of ICAC are subsequently delegated to these professional associations.⁷²

‘Under the new structure of specialization introduced by the Audit Law,’⁷³ the professional associations were assigned the roles of drafting technical auditing standards, ensuring quality control, organizing continuous professional training, and organizing the mandatory examinations and control of practical experience required to enter the profession.⁷⁴ The AECA for example, has been at the forefront of standard setting in Spain. Its approach to standard setting has been a participative one, where a cross section of institutions involved in preparation, verification and use of financial statements are brought together to discuss their views.⁷⁵ In fact, the AECA’s recommendations are commonly adopted by companies and frequently form the basis for

⁶⁷ LAC 2015, ss 7, 8 and 27 (4). LAC 2015, ss 9 and 41 accord auditors of the European Union and other countries the opportunity to practice in Spain on grounds of reciprocity.

⁶⁸ Except those companies that can present an abridged income statement

⁶⁹ Barbadillo, Humphrey and García Benau, *Auditors versus Third Parties*, (n 67) 122.

⁷⁰ RAC 2021, s 104.

⁷¹ *ibid.*

⁷² LAC 2015, ss 24, 27 and RAC 2021, s 105.

⁷³ Gonzalo and Gallizo, *European Financial Reporting*, (n 55) 98.

⁷⁴ *ibid.*

⁷⁵ *ibid* 95.

subsequent official regulations from the ICAC.⁷⁶ The ICAC, where necessary, may ask these professional bodies to elaborate, revise or adapt any technical rule or norm. If they fail to act accordingly after the expiration of six months, the ICAC will employ its power of last resort and proceed to adapt the rule.⁷⁷ Thus, 'while the professional associations were given a degree of flexibility, their activities were to be subject to the approval and oversight of ICAC'.⁷⁸

4.2 Comisión Nacional del Mercado de Valores

Another body engaged in financial regulation is the National Securities Market Commission "Comisión Nacional del Mercado de Valores" (CNMV).⁷⁹ The CNMV is a body corporate established under section 13 of the Securities Market Law "Ley 24/1988, de 28 de julio, del Mercado de Valores."⁸⁰ It is composed of a chair and vice chair that must be knowledgeable in the field of securities, and are to be appointed by the government on the recommendation of the Minister of economy and Finance. Other members are the Director-General of the Treasury, the Vice President of the Central Bank and three members to be nominated by the Minister of Economy and Finance.⁸¹

The CNMV has the mandate to oversee the activities of the Spanish Stock Exchange and foster transparency and efficiency in the capital market. It also protects investors from unfair prices by promoting fair financial reporting, and generally, enforcing the provisions of the Spanish security law.⁸²

⁷⁶ Catherine Gowthorpe and John Blake (eds), *Ethical Issues in Accounting* (Routledge 1998) 8 <http://books.google.es/books> accessed 10 September 2024

⁷⁷ LAC 2015, s 27 (3) and RAC 2021 s 24.

⁷⁸ RAC 2021, s 105 and Barbadillo, Humphrey and García Benau, *Auditors versus Third Parties*, (n 67) 124.

⁷⁹ "Ley 24/1988, de 28 de julio, del Mercado de Valores." Spanish Stock Market Law (LMV 1988) s 84.

⁸⁰ Amended by LMV 1988.

⁸¹ LMV 1988, s 17.

⁸² LMV 1988, ss 13-14 and Leandro Cañibano and José Luis Uceda, *Accounting and Financial Reporting in Spain* (2005) <www.uam.es/~pdi/.../canibano_uced_a_2005.pdf> accessed 7 September 2024, for a general discussion on Spanish accounting regulation.

4.3 Audit Conduct in the United States

The conduct of audit in the United States is generally reserved for a duly qualified accountant, statutorily referred to as a Certified Public Accountant⁸³ who has passed the relevant examination⁸⁴ and have met the additional practical experience required. He must also seek a license to practice in the state concerned.⁸⁵ Certified Public Accountants must have professional insurance and can practice individually, in partnership as well as by forming a body corporate.

As indicated above, audit is regulated by federal as well as state legislation.⁸⁶ Since there is no federal legislation with regard to company law regulation in the United States, auditors' duties and responsibilities as well as their liabilities have developed at state levels. Nonetheless, auditor's duties to investors who may buy or sell shares have developed through federal securities legislation. Securities legislations are set out at the federal level but company law operates at state level with the attendant variations from one state to another.

Although, auditors' duties are generally spelt out by law, their relationship with audited companies is essentially contractual. Their certificate is primarily prepared in the shareholders' interest. Yet their allegiance goes far more than to their clients; they hold the trust of the creditors as well as the investing public. Moreover, to ensure their objectivity, auditors must act in total independence of their client company. At least this has been the object of the new legal regime now in place in the United States that has moved the audit committee to the forefront of a public company's relationship with auditors. The

⁸³ Schedule A, pp 25-27 of SA 1933, requires that the balance sheet and account of profits and losses be "certified by an independent public or certified public accountant". See also section 12 of the SEA 1934 ss 12. Meanwhile, section 13 (a) of SEA 1934 specifies that annual accounts must be certified by an Independent Public Accountant.

⁸⁴ The Uniform Certified Public Accountants Examination (AICPA, 2023).

⁸⁵ Accountants are required to obtain a practising license in any state they choose to practice in.

⁸⁶ Jones, Does Federalism Matter, (n15) 889.

committee is now directly responsible for the appointment, compensation and oversight of the work of auditors.⁸⁷ Auditors are directly answerable to the committee.⁸⁸

Auditors have a duty growing out of contract to make their certificate with due diligence and care proper to their calling and a duty imposed by law to make it objectively, independently and without fraud. Besides, they have overall obligation to provide assurance to users of financial statements of the accuracy of the assertions made by the management and ensure that it is fair and complies with the *General Accepted Accounting Principles* (GAAP).⁸⁹

At the end of each financial year, company's financial statements accompanied by auditor's certificate as approved by the shareholders at a general meeting must be filed at the SEC. Auditors are now required to not only certify the integrity of their client's financial statements, but also assess the mechanisms that their corporate clients have adopted to generate the financial information that goes into those statements.⁹⁰

Every shareholder has a right to receive a copy of the financial statements and to make extracts from them before an annual general meeting. However, when a company publishes its account with the aim of inviting the general public or any class thereof, to read the financial statements such must be accompanied by an auditor's certification. In practice financial statements are also sent to third parties to attract investment, contracts and finance.⁹¹

4.4 The Certificate of "auditor de cuentas"

Auditing, according to section 1 LAC comprises of review and verification of accounting documents to produce a reliable (audit) report that affects third parties. In Spanish legal tradition, auditing is not an

⁸⁷ SOX 2002, s 301.

⁸⁸ *ibid* 202.

⁸⁹ Panttaja, Accountants' Duty to Third Parties, (n 2) 931.

⁹⁰ SOX 2002, s 404 (b) and Glenn R Hubbard, *Money, the Financial System, and the Economy* (6th ed., Pearson 2007) 92.

⁹¹ Lara Khoury, *The Liability of Auditors*, (n 11) 424.

end in itself but a means to an end. As such the “auditor de cuentas” is viewed as a professional whose work entails a responsibility towards his client as well as protecting shareholder's and third party's interests.⁹² Auditors have a statutory duty to act not only in the interest of their clients but rather for the public good.⁹³ Their role is seen not only in the service they render their clients but also in the effect their service would have on third parties, to whom they owe a duty of care as well.⁹⁴ As enunciated in the dictum of Judge Santiago Pablo Soldevila Frago:

“De lo expuesto se deduce, de forma inequívoca, que con el ejercicio de esta actividad se persigue proteger un interés público identificado con la garantía de la máxima transparencia en el análisis de la información económico-contable de las empresas, cuyo respeto será el parámetro desde el que debe juzgarse el ajuste legal de la actividad profesional de los auditores de cuentas.”⁹⁵

Only “auditor de cuentas” registered in the Official Registry of Auditors (ROAC) of the ICAC,⁹⁶ is entitled to practice auditing through the professional associations recognized by law.⁹⁷ Any person who satisfies the requirements outlined under sections 8 to 10 of the amended Audit law can be admitted to practice auditing in Spain.⁹⁸ Auditors in Spain must hold professional insurance⁹⁹ and are held to a high standard of

⁹² LAC 2015, s 1.

⁹³ *ibid* 6 (3) and Francisco Valenzuela González, *La Información en la Sociedad Anónima y en el Mercado de Valores* (Ed Civitas 1993) 162.

⁹⁴ The provision of section 1 LAC above emphasized the importance of accurate and responsible information for the investing public.

⁹⁵ Spanish case Sentencia de 14 febrero 2005 JUR 2007\209229

⁹⁶ LAC 2015, s 7.

⁹⁷ Every auditor or audit firm must be registered with one of these three statutory recognized professional associations to be entitled to practice auditing.

⁹⁸ RAC 2021, s 25.

⁹⁹ LAC 2015, s 23. The quantity of the insurance sum is to be determined by “Ministerio de Economía y Hacienda” in proportion to the size of the business.

independence¹⁰⁰ from their clients and are sanctioned for its violation.¹⁰¹ They may practice in sole proprietorship or in a “sociedad de auditoria de cuentas.”¹⁰² The “sociedad” however is severally and jointly liable for damages occasioned by their member’s fault.¹⁰³

As a general rule, all bodies undertaking economic activities must maintain¹⁰⁴ and prepare financial statements at the end of each financial year.¹⁰⁵ In case of a public company such financial statements are to be revised and certified by “auditor de cuentas”¹⁰⁶ and deposited at the Mercantile Registry depending on the type of “empresa”.¹⁰⁷ The “auditor de cuentas”, may be appointed by the shareholders,¹⁰⁸ the Mercantile Registry,¹⁰⁹ or by a judge.¹¹⁰

“Auditores de cuentas” have many responsibilities, but their main and most renowned task is to verify and ascertain if financial statements represent the fair view of the assets and financial situation of

¹⁰⁰ Under LAC 2015, ss 12-13, auditors must not only be independent but must also be seen to be so. For this reason, LAC 2015, s 44 sets out situations where auditors are deemed not independent.

¹⁰¹ LAC 2015, s 33. ICAC in the exercise of its sanction regime can fine an auditor or strike out his name off the ROAC depending on the gravity of the offence.

¹⁰² LAC 2015, s 7.

¹⁰³ *ibid* 22, any liability caps negotiated by an auditor do not affect a third party.

¹⁰⁴ Section 34 “Código de Comercio de 1885.” The Spanish Commercial Code (CC 1885) s 34 Ley de Sociedades de Capital (Real Decreto Legislativo 1/2010, 2 de julio) the Spanish Companies Act 2010 (LSC 2010) s 34.

¹⁰⁵ If the company does not deposit its accounts in the Mercantile Register, it will be penalised, the next year, with the closure of the registry, which despite not being a monetary sanction is especially effective, because the company isn’t allowed to register any mercantile action such as inscription of new statutes, members of council, economic transactions and so on, thereby strongly limiting the company activity. Furthermore, the ICAC, as stated by LSC, 2010 s 283 could penalise the company with a monetary sanction of from 1200 to 60,000 Euros.

¹⁰⁶ Section 263(1) LSC, 2010 s 263 (1) companies that cannot meet the conditions outlined in section 258 LSC, 2010 are exempted from this general rule.

¹⁰⁷ A company must prepare an abridged balance sheet of its net asset if it meets two out of the three criteria outlined in section 257 LSC 2010.

¹⁰⁸ LSC 2010, s 264.

¹⁰⁹ *ibid* 265.

¹¹⁰ *ibid* 266.

companies.¹¹¹ Their opinion should be issued in accordance with the audit law and technical auditing standards.

These standards are to be under the general principles and practices allowed in the member countries of the EU as developed and adapted by the relevant professional bodies and approved by the ICAC.¹¹² Apart from this, the auditor is also required to express in clear and concise language, whether the account statements are fair representation of the company's assets under the accounting principles applied.¹¹³ It must be noted however, that the auditor cannot guarantee these accounts. Since he must comply with the professional requirements of prudence, due diligence and competence, once those are fulfilled the auditor is deemed to have discharged his duty.

Financial statements as well as auditor's certificate are to be presented before the shareholders at an annual general meeting¹¹⁴ and must be deposited at the Mercantile Registry within the same month of its approval.¹¹⁵ Moreover, once filed at the registry it becomes a public document and third parties can access it.¹¹⁶ As is the case in the United States, in Spain as well these documents are usually revealed to third parties by the administrators of companies for business ends.

¹¹¹ *ibid* 263 and LAC 2015, s 1.

¹¹² RAC 2021, s 17 and Barbadillo, Humphrey and García Benau, *Auditors versus Third Parties*, (n 67) 124.

¹¹³ LAC 2015, s 3.

¹¹⁴ LSC 2010, 272.

¹¹⁵ *ibid* 279.

¹¹⁶ *ibid* 281.

5.0 Conclusion and Recommendations

The line to be drawn between the two systems is that unlike in the US where semi-public regulatory authority was introduced as a result of the Enron scandal; in Spain, audit regulation has been public since the advent of the 1988 Audit Law. Another difference is how auditors are remunerated. Contrary to the practice in the US where fees are based on time spent on the audit engagement, in Spain auditing fees are established before the service, using a scale based on a formula related to the size of the audited firm. In addition, whereas the targets of financial statements in the US are primarily the shareholders, in Spain emphasis is placed on the use of the statements by the general public to whom the Auditor is statutorily liable as well. However, like the non-audit services prohibition list introduced by the Sarbanes-Oxley Act as a safeguard against Andersen-like debacle, the new Spanish Audit Law contains provisions on incompatibility aimed at promoting auditor independence. Finally, it is pertinent to point out that these measures were brought about as a result of a worldwide trend of corporate review provoked by the Enron scandal. But are they enough to prevent the repeat of disasters of similar scale? Only time will tell. However, beyond any strict compliance with the rules lies the act of prudence and professionalism which the auditor must conscientiously observe. Any imprudence on the part of the auditor that causes loss to third parties may lead to an action in negligence.