

**REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)****Peru****ACCOUNTING AND AUDITING****June 10, 2004****Contents**

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**Overview**

This report provides an assessment of accounting, financial reporting and auditing practices within the corporate sector in Peru, using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and drawing on international experience and best practices in that field.

The Accounting Standards Board is the official standard-setting body for private sector accounting, with broad participation of country stakeholders from both private and public sectors, and under the leadership of the Accountant General's Office within the Ministry of Economy and Finance. From 1994 to 1998, Peru officially adopted International Accounting Standards (IAS, which since then have been incorporated within IFRS). This contributed to the significant improvement of the quality of the private sector's financial reporting. However the Accounting Standards Board should have sufficient resources to maintain the standards up-to-date at an adequate pace, and to ensure their dissemination, with the support of the accounting profession. Similarly, ISA were adopted by the accounting profession in 1998 but the Peruvian version of the standards has not been updated since then, while ISA were substantially modified.

The ROSC Accounting & Auditing review included the analysis of a sample of 20 published audited financial statements and found that financial reporting standards were broadly complied with by Peruvian corporations, although a number of cases of departures from IAS, and possibly from ISA, were noted. This points to the need to strengthen the enforcement of financial reporting and auditing requirements for entities of public interest.

The review also noted that existing arrangements for the licensing of auditors do not provide a compulsory minimum academic course content in accounting and auditing, nor do they include professional examination; moreover, continuing education requirements are not effectively followed. This is detrimental to the quality of the accounting and audit practice in the country. The lack of quality control of auditors is also a cause of serious concern.

The Peru ROSC Accounting & Auditing offers several policy recommendations aimed at strengthening the regulatory framework governing accounting and auditing, including establishing an independent oversight body for the audit profession that would ensure auditors are qualified with a strong academic background and professional skills and that they comply effectively with both ISA and applicable ethical requirements. Another recommendation of this ROSC is that large, non-listed companies be required to have their financial statements audited and to publish these financial statements through CONASEV.

This report was prepared by a World Bank team (LCOAA) on the basis of the findings from a diagnostic review carried out in Lima from October 2003 to May 2004. The study was led by Henri Fortin who was assisted by consultant Alfredo Rodríguez Neira. Jamil Sopher provided assistance to the team with regards to quality review. The task team also received the support of the World Bank Country Management Unit in Washington and Lima (LCC6C) and OPCS. The ROSC study was conducted through a participatory process involving various stakeholders and led by the country authorities. The ROSC assessment was cleared by the Ministry of Economy and Finance on January 4, 2006.

## MAIN ABBREVIATIONS AND ACRONYMS

AIC	Inter-American Accounting Association
BVL	Lima Stock Exchange
CGN	Accountant General of Peru
CGR	Auditor General of the Republic
CNC	Accounting Standards Board
CONASEV	National Supervisory Commission of Enterprises and Securities
CPC	<i>contador público colegiado</i>
CPN	Accountant General's Office
DNCP	National Public Accounting Department
FCCPP	Federation of Colleges of Public Accountants of Peru
FDI	Foreign Direct Investment
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GDP	Gross Domestic Product
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IES	International Education Standards for Professional Accountants
IFAC	International Federation of Accountants
IFRIC	International Financial Reporting Interpretation Committee
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPAI	Institute of Independent Auditors of Peru
ISA	International Standards on Auditing
LGSFS	General Law of the Financial and Insurance System
LGS	Company Law
LMAFSP	General Law on Public Sector Financial Management
LMV	Securities Market Law
LSNC	Law on the National Accounting System
MEF	Ministry of Economy and Finance
NIA	<i>Normas Internacionales de Auditoría</i>
NIC	<i>Normas Internacionales de Contabilidad</i>
OECD	Organization for Economic Cooperation and Development
PCAOB	U.S. Public Company Accounting Oversight Board
RIF	Regulation on Financial Information
RUNSA	<i>Registro Único de Sociedades de Auditoría</i>
ROSC	Reports on the Observance of Standards and Codes
SAA	Open Corporations ( <i>Sociedades Anónimas Abiertas</i> )
SBS	Superintendency of Bank and Insurance
SIC	Standing Interpretation Committee
SME	Small and Medium Enterprises
SOE	State-Owned Enterprises
SPP	Private Pension Management System
UIT	<i>unidad impositiva tributaria</i> (equivalent to approximately US\$900)

## EXECUTIVE SUMMARY

### A. Summary of Observations

The overall objective of this ROSC assessment is to assist the Government in strengthening private sector accounting and auditing practices and in enhancing financial transparency in the corporate sector. Such a policy would foster competitiveness and economic integration at regional and international levels, which are key development objectives for Peru. Insofar as they would support these objectives, the recommendations set forth by the ROSC Accounting & Auditing would benefit a variety of stakeholders, including:

- The securities market (BVL), whose capacity to attract foreign investment would be enhanced by further compliance with international standards;
- Peru's financial sector in general, as investors and banks could base their business decisions on more reliable information;
- Peruvian enterprises, who would gain easier and cheaper access to capital—this is especially likely for SMEs and large non-listed enterprises;
- Employees of the private sector, who have an important stake in their company's success and are therefore entitled to receive complete and accurate financial information. The reliability of financial statements is also directly relevant to workers since the law grants them a share of corporate profits. In addition, more transparent financial information would help private pension funds improve their investments, which in turn would benefit future retirees;
- The public sector, since taxes on corporate profits are based on accounting records, and in the perspective of future concessions or privatizations.

The principal findings of the ROSC Accounting & Auditing in Peru are:

- (i) The public sector has been very active over the last ten years in improving accounting standards for private sector entities. The Accountant General's Office (CPN), through the Accounting Standards Board (CNC), has played a major role in the adoption of accounting standards of high quality. It has also made substantial contributions to their dissemination among corporations and the accounting profession by publishing guidance material on how to use the standards and organizing courses and seminars on the topic. The two regulatory agencies overseeing capital markets (CONASEV) and the financial sector (SBS) also have important responsibilities, especially for enforcing accounting standards.
- (ii) Peru adopted International Accounting Standards (IAS) gradually from 1994 to 1998. This process has continued with the adoption of some of the international standards recently. International Standards on Auditing (ISA) were officially endorsed in 1998. This has led to a significant improvement in the quality of the financial information among large companies. Yet, due mainly to CNC's lack of resources, the previously adopted accounting standards have not been updated in a timely fashion, nor have the recently issued International Financial Reporting Standards (IFRS) been incorporated by CNC. As for auditing standards, they have remained the same since 1998, while several ISAs were being issued during that period. Such delays adversely impact the accounting and auditing standards' ability to help produce accurate and reliable information for the financial statement users.

- (iii) The adoption of international standards has not brought similar achievements for SMEs, and users of financial statements perceive that the financial information provided by SMEs has limited reliability, which is often detrimental to SME access to financing.
- (iv) CONASEV and SBS enjoy accounting standard-setting privileges in their specific areas of purview. SBS has used that prerogative extensively, setting a number of detailed accounting rules for banks, insurance companies, etc, to be applied for both regulatory and general-purpose financial reporting. These rules reflect international practices in matters of disclosure on specific aspects of the banking and insurance sectors. However, a number of these sector-specific accounting rules used in the preparation of general-purpose financial statements are inconsistent with IFRS. CONASEV has passed one regulation dealing with accounting that was meant to facilitate the transition to international standards by allowing that the recognition of deferred income tax liabilities be spread over 13 years; but that regulation contradicts IFRS which require such liabilities to be recognized immediately—a regrettable precedent that could not be repeated however, since the Law was amended afterwards to prevent that.
- (v) As a result of CONASEV’s efforts, public access to financial statements and related corporate information is easy and timely. This contributes to the financial transparency of the securities market and to investors’ confidence.
- (vi) Until recently, CONASEV’s mandate included a large number of non-listed companies, but this mandate was restricted by law to listed companies in 2000. This has significantly reduced the availability to investors and banks of financial information on non-listed enterprises.
- (vii) Membership in the professional accounting associations, or *colegios*, is compulsory for accountants in the public practice. The *colegios* enjoy significant privileges under the law including the licensing of auditors and standard-setting in the field of auditing and accountant professional conduct.
- (viii) The license to conduct audits is awarded by the *colegios*, who do not require a professional examination. Moreover, once accountants are qualified, there is no continuing education or quality control requirement for them to retain their licenses.
- (ix) The accounting profession’s code of ethics sets fundamental principles but lacks precision and guidance on how the code should be applied.
- (x) There is no minimum course content set nationwide regarding the university curricula in accounting; the quality of accounting education at national level is therefore inconsistent.
- (xi) Enforcement of accounting and auditing standards by the regulatory agencies is hampered by a lack of resources, especially in the case of CONASEV, and by the fact that both CONASEV and SBS lost their powers to award and repeal the license of statutory auditor.
- (xii) The *colegios* do not enforce auditing standards or the code of ethics, although they are required to do so under the law; thus, sanctions against practitioners are very rarely imposed.
- (xiii) As in most Latin American countries, audit committees are not mandated by law and are in fact uncommon among Peruvian companies. Regarding listed companies, CONASEV’s voluntary code of good practices of corporate governance recommends that special committees of the Board be established, including on audit. In the banking and insurance

sectors, SBS-issued norms on internal audit and internal control systems requires companies to set-up audit committees.

- (xiv) The legislation applicable to accounting and auditing in the private sector is relatively recent and appears to provide an adequate basis for strengthening financial reporting practices in the near future, although certain of the recommendations of this ROSC require further enhancing the existing law.

## **B. Policy Recommendations**

The recommendations arising from this ROSC Accounting and Auditing will be presented to the country stakeholders during a workshop in Lima where a Country Action Plan will be developed. The Ministry of Economy and Finance will oversee the implementation of the Action Plan with the assistance of the World Bank and possibly other international development partners. The Action Plan should consider the following components:

- 1) The Accounting Standards Board (CNC) should be allocated, through the National Public Accounting Department (DNCP), a specific recurrent budget or personnel, sufficient for it to carry-out its responsibilities, mainly the adoption of IFRS, fully and in a timely fashion—including the translation of the exposure drafts, i.e. before the standards are approved by the international standard-setting body (IASB). This would allow issuers and auditors to refer to IFRS, thereby enhancing investors' confidence in applicable standards.
- 2) CNC should seek cooperation with other Spanish-speaking standard-setters so as to obtain economies of scale in the standard-setting process, including translation of IFRS, and maximize comparability among Latin American countries.
- 3) In order to help SMEs improve the quality of their financial information and therefore their ability to access credit, CNC should as a matter of priority establish simplified accounting and financial reporting standards that could be used by SMEs on a voluntary basis.
- 4) Large non-listed companies should be required to present annual audited financial statements and these statements should be publicly available through CONASEV.
- 5) CONASEV's enforcement capacity should be strengthened in order to improve the level of compliance by companies with financial reporting requirements, and thus achieve a higher quality of information.
- 6) In the financial sector, SBS in cooperation with CNC should seek to harmonize accounting principles to be applied by banks and insurance companies for their general-purpose financial reporting toward full alignment with IFRS. Such adoption implies a period of transition during which institutions in the banking, insurance and pension systems, as well as their auditors and other stakeholders, will be able to anticipate the impacts of such adoption and adequately prepare it.
- 7) With regards to ethical standards, the accountancy's professional bodies (the *colegios* and their federal body FCCPP) should strengthen the accountants' code of ethics to clarify incompatibilities and incorporate the content of the current International Federation of Accountants' (IFAC) ethics code. The authorities should be involved in that process so that they could give their formal endorsement to the ethics code for statutory audit purposes.

8) Peruvian authorities entrusted with regulating the public accounting profession and the audit practice (i.e., the Accountant General’s Office, CONASEV, the SBS and the Auditor General of the Republic) should establish an independent auditor oversight body in order to increase the accountability of practitioners, especially independent auditors. The mission of the oversight body would include: a) awarding, renewing and repealing licenses for statutory auditors among listed or regulated companies, banks, and other public-interest entities; b) ensuring statutory auditors get adequate continuing education; c) enforcing auditing standards; and d) monitoring statutory auditors’ compliance with independence requirements. Following the model of the CNC and that of audit oversight bodies in other countries (e.g., France, Spain, the U.S.), the oversight board would be governed by a majority of public authorities’ representatives and other non-practitioners. The accounting profession would be involved in the work conducted by the oversight body and the conduct of part of the oversight functions—such as continuing education or professional examination—could be delegated under clear arrangements and strict conditions that would protect the integrity of the system. The involvement of the Auditor General would be important to ensure the consistency of the external audit practice in both the public and private sectors.

9) The authorities should seek, in cooperation with the universities, to harmonize and strengthen academic curricula in the field of accounting and auditing so that future practitioners have sufficient knowledge and competence to undertake the responsibilities of *contador público*, and even more so those of statutory auditor.

10) A system of certification of professional accountants should be established under the authority of the auditor oversight board; such certification should be required for awarding the license of statutory auditors.

11) Substantial Technical Assistance will be needed to put the above recommendations into practice on various aspects including: establishing the independent auditor oversight system, designing procedures for regulators to enforce financial reporting requirements, drafting amendment to existing legislation and/or regulations and addressing related human resources issues. Establishing the audit oversight body and strengthening regulators’ enforcement may also entail substantial training. The Country Action Plan will address the content, cost and funding of the Technical Assistance and training needs, as well as the issue of specifying the resources that need to be allocated to the audit oversight body, the CNC and CONASEV. As regards the support provided by the World Bank, the ROSC team will provide follow-up assistance to the authorities to seek international funding from specific sources that support the types of reforms contemplated by this report (e.g., the First initiative, the Multilateral Investment Fund, Consulting Trust Funds, etc.)

<b>SUMMARY OF RECOMMENDATIONS (IN THE ORDER IN WHICH THEY APPEAR IN THE REPORT)</b>					
<b>Description of Action</b>	<b>Priority</b> (see footnote)	<b>Responsibility</b>	<b>Timing of effective implementation</b>		
			<b>Short-term</b> (less than 1 year)	<b>Medium-term</b> (1 to 3 years)	<b>Long-term</b> (3 to 5 years)
1. Allocate a specific recurrent budget or personnel for CNC (through DNCP) so that it could carry-out its responsibilities fully and in a timely fashion – The level of resources needed for the CNC to function adequately should be estimated as part of the preparation of the Country Action Plan	(a)	MoF	x		
2. Seek cooperation with other Spanish-speaking standard-setters in order to generate economies of scale in the standard-setting process	(c)	CNC	x		
3. Establish simplified accounting and financial reporting standards for SMEs (taking into account the progress of IASB's SME standard project), so as to improve the quality of their financial information and therefore their ability to access credit	(c), (d)	CNC		x <sup>(d)</sup>	
4. Require Peru's largest non-listed companies to present annual audited financial statements and that these statements be made available to the public	(b)	MoF / CONASEV		x	
5. Strengthen CONASEV's enforcement capacity to achieve a higher quality of corporate financial information	(a)	MoF	x		
6. Harmonize accounting principles for banks' or insurance companies' general-purpose financial reporting with IFRS	(b)	SBS (in cooperation with CNC)		x	

Notes:

- (a) Strengthening existing institutions and the compliance with existing standards and regulations
- (b) Enhancing the legal framework for accounting and auditing regulation
- (c) Other actions aimed at strengthening the underpinnings of the financial reporting regime
- (d) Pending issuance of IASB's SME standards

<b>SUMMARY OF RECOMMENDATIONS (CONTINUED)</b>					
<b>Description of Action</b>	<b>Priority</b> (see footnote)	<b>Responsibility</b>	<b>Timing of effective implementation</b>		
			<b>Short-term</b> (less than 1 year)	<b>Medium-term</b> (1 to 3 years)	<b>Long-term</b> (3 to 5 years)
7. Strengthen the code of ethics for professional accountants to clarify incompatibilities and align it with IFAC's	(a)	FCCPP (in cooperation with CONASEV, SBS and CGR)	x		
8. Establish an independent Auditor Oversight Board (AOB) for licensing and monitoring statutory auditors among all regulated companies	(b)	CONASEV and SBS (in cooperation with CGR and FCCPP)		x	
9. Harmonize and strengthen academic curricula in the field of accounting and auditing so that future practitioners have sufficient knowledge and competence	(a)	MoF, Ministry of Education, Assembly of Rectors			x
10. Establish a system of professional certification required for awarding the license of statutory auditor	(b)	AOB			x
11. Introduce training programs for regulators on accounting and auditing standards and enforcement of financial reporting requirements	(a)	AOB, CONASEV, CGR, SBS, CNC, DNCP		x	
12. Elaborate a Country Action Plan for the implementation of the ROSC A&A's recommendations	(a), (b) and (c)	MoF (in cooperation with in-country stakeholders)	x		

Notes:

- (a) Strengthening existing institutions and the compliance with existing standards and regulations
- (b) Enhancing the legal framework for accounting and auditing regulation
- (c) Other actions aimed at strengthening the underpinnings of the financial reporting regime



SUMMARY OF RECOMMENDATIONS (BY THEMES – IN SEQUENCE)				
No. (see above)	Description of Action	Responsibility	Timing of effective implementation	
			Short-term (< 1 year)	Medium-term (1 to 3 years)
<b>GENERAL</b>				
12	Elaborate a Country Action Plan for the implementation of the ROSC A&A's recommendations	MoF (with in-country stakeholders)	↑	
4	Require Peru's largest non-listed companies to present annual audited financial statements and publish them	MoF	↑	
<b>ACCOUNTING STANDARDS</b>				
1	Allocate a specific recurrent budget or personnel for CNC to carry-out its responsibilities adequately	CNC	↑	
2	Seek cooperation with other Spanish-speaking standard-setters	CNC	↑	
3	Establish SME accounting and financial reporting standards taking into account the progress of IASB's SME standard project	CNC		↑ *
<b>AUDITING STANDARDS – PRACTITIONERS' ACCOUNTABILITY REGIME</b>				
7	Strengthen the code of ethics for professional accountants ethics to clarify incompatibilities and align it with IFAC's	FCCPP (with CONASEV, SBS and CGR)	↑	
8	Establish an independent Auditor Oversight Board (AOB) for licensing and monitoring auditors in regulated companies	CONASEV and SBS (with CGR and FCCPP)		↑
10	Establish a system of professional certification required for awarding the license of statutory auditor	AOB		↑
9	Harmonize and strengthen academic curricula in the field of accounting and auditing	MoF, Ministry of Education, Rectors		↑
<b>FINANCIAL SECTOR REGULATION</b>				
5	Strengthen CONASEV's enforcement capacity to achieve a higher quality of corporate financial information	MoF / CONASEV	↑	
11	Introduce training programs for regulators on accounting and auditing standards and enforcement of financial reporting requirements	AOB, CONASEV, CGR, SBS, CNC, DNCP		↑
6	Harmonize accounting principles for banks' or insurance companies' for general-purpose financial reporting with IFRS	SBS (in cooperation with CNC)		↑

\* Pending issuance of IASB's SME standards

## I. BACKGROUND

1. This review of accounting and auditing practices in Peru forms part of the World Bank's and the International Monetary Fund's (IMF) comprehensive joint initiative on Reports on the Observance of Standards and Codes (ROSC). The review focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of financial reporting in the private and corporate public sectors in Peru. International Financial Reporting Standards (IFRS)<sup>1</sup> and International Standards on Auditing (ISA)<sup>2</sup> were used as benchmarks for the assessment, and the review involved a study of both mandatory requirements and actual practices.

2. **During the last decade, Peru's public policies have been oriented toward free-trade, privatization and fiscal reform.** They have achieved noticeable results on the macro-economic level, with GDP more than doubling in dollar terms over that period and with a record growth rate of 12.9% in 1994. Inflation has also been controlled at 2 to 2.5% per annum and the national currency ("Nuevo Sol") has stabilized at 3.5 to the US dollar. Investment in infrastructure and services, especially from foreign direct investment (FDI), has contributed to improvements in the country's social indicators.

3. **Since 2003, the administration which came to power in 2001 under the leadership of President Toledo has been praised for its policy of fiscal responsibility and its commitment to strengthening public institutions as one of several approaches to fighting poverty more effectively.** After 2000, Peru's economy suffered from the effects of the worldwide recession and the political instability and slowdown in the pace of reforms. This affected the investment climate negatively. The traditional shortcomings in the country's public administration—including lack of accountability, of policy coordination, and of coherent public sector employment system; duplication of programs; excessive centralization; etc.—are often cited as factors adding to the country's economic challenges. Recent indicators point to a recovery in the economic activity, with an increase in GDP by 3.8% in 2003 and an estimated 5% in 2004. Such sustained economic growth is expected to help significantly reduce Peru's fiscal deficits (non-financial public-sector deficit was 1.8% in 2003, down from 3.4% in 2000). Poverty affected 54.8% of Peruvians in 2001, with 24.4% of the population living in extreme poverty.

4. **Securities markets still play a modest role in providing funding to corporate entities.** There are 224 companies listed on the Lima Stock Exchange<sup>3</sup> (*Bolsa de Valores de Lima* or BVL), most of which are still controlled by family interests. Pension funds have a significant presence on the securities market where approximately 50% of their assets are invested.<sup>4</sup> As a consequence, a small number of companies are actively traded on the stock market. In the banking sector, there are 14 banks owning aggregate assets of US\$17.6 billion as of September 2003. The insurance sector comprises 14 companies and represents total annual premiums of about US\$300 million.

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<sup>1</sup> IFRS correspond to the pronouncements issued by the International Accounting Standards Board (IASB) and International Accounting Standards (IAS) issued by its predecessor, the International Accounting Standards Committee (IASC), as well as related official interpretations.

<sup>2</sup> Issued by the International Auditing and Assurance Standards Board (IAASB) within the International Federation of Accountants (IFAC).

<sup>3</sup> Four of these companies are also listed in the U.S.

<sup>4</sup> Private pension funds had total assets of 14.8 billion Nuevos Soles as of December 31, 2002, of which 5.2 were equity securities and 2.2 corporate bonds (source: World Bank report on Peruvian pension system – January 2004).

5. **Several of the key components of the Peruvian government’s strategy to reduce poverty and support the country’s economic development depend on strong financial reporting, accounting and auditing practices by the private sector.** These components are:

- Creating a better investment environment in order to improve competitiveness and achieve sustained economic growth – In that regard, enhanced financial transparency is critical to attracting FDI, and this can only be achieved by maintaining sound financial reporting practices within the private sector. This is all the more important as there are indications that the banking sector is reluctant to lend to a highly indebted corporate sector, which constrains Peru’s competitiveness;
- The need for tax reform to increase overall tax revenues to 15% of GDP – The reliability of the financial information produced by corporate taxpayers will be essential to enable the government to enhance tax revenue generation;
- An ambitious privatization program that will attempt to draw a projected investment of over US\$ 11 billion – This objective can only be achieved with the active involvement of international investors and industrial groups; strengthening corporate financial reporting practices in Peru will be necessary to attract such international players. From the Government’s standpoint, accessing reliable financial information will be key to maximizing revenues derived from these transactions and to monitor those activities once privatized; in the same manner, long-term concessions of state-owned activities or assets will require adequate financial supervision on the Government’s part, including through quality financial reporting;
- As part of structural reforms, the strengthening of bank supervision – In this respect, strong accounting and auditing practices are an essential element, as emphasized by the recommendations of the Basel Committee on Banking Supervision.

## II. INSTITUTIONAL FRAMEWORK FOR PRIVATE SECTOR ACCOUNTING AND AUDITING

### A. Statutory Framework

6. **Basic requirements for accounting, financial reporting and auditing in Peru are set out in the code of commerce and in Company Law (*Ley General de Sociedades*, or LGS) of December 1997.** The code of commerce issued in 1902 establishes the obligation for companies to keep books of accounts, a ledger and other basic accounting records. The most common legal business structure in Peru among those provided by the LGS<sup>5</sup> is the corporation (*Sociedad Anónima* or S.A.). Under the LGS, the board of directors of an S.A. must “provide the shareholders and the public with sufficient, trustworthy and appropriate information (...) with respect to the company’s legal, economic and financial situation”. It also obliges the board of directors to convene a meetings of the shareholders’ general assembly when the equity has been reduced by losses to less than half of issued stock. The LGS requires that financial statements of corporations be prepared and presented in accordance with generally accepted accounting principles (GAAP) in Peru, but the LGS does not further define these principles. Through a provision of the by-laws of the company or through a motion of the general meeting adopted by at least 10% of shares with voting power, shareholders may decide that company should undergo an external audit.

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<sup>5</sup> Law 26887-1997.

7. **When preparing their statutory annual financial statements, corporate entities<sup>6</sup> in Peru must follow IAS as officially endorsed by the Accounting Standards Board (*Consejo Normativo de Contabilidad* or CNC).** The CNC was established under the Law on the National Accounting System (*Ley del Sistema Nacional de Contabilidad* or LSNC<sup>7</sup>) of 1987 as the official standard-setting body for both public and private corporate sectors accounting. It is composed of representatives of various public institutions, the accounting profession, the universities and the business community. It has been established under the leadership of the Accountant General's Office (*Contaduría Pública de la Nación* or CPN), a division of the Ministry of Economy and Finance (MEF).<sup>8</sup> In an effort to strengthen the country's accounting standards, the CNC issued a series of resolutions from 1994 to 1998<sup>9</sup> by which, pursuant to the LGS, it officially adopted IAS as Peruvian GAAP for the purposes of statutory financial reporting.

8. **Corporations whose shares are publicly traded or whose shareholding structure meet certain criteria that indicate significant minority interests are subject to compulsory audits of their annual financial statements, among other additional financial reporting and related requirements.** The LGS contemplates two types of corporations: "open" corporations (*Sociedades Anónimas Abiertas*, or S.A.A.), i.e. S.A.s who have: (i) made an initial public offering of stock or convertible bonds; (ii) more than 750 shareholders; or (iii) 175 or more shareholders controlling at least more than 0.2% and less than 5% of the stock individually and 35% or more of the stock collectively;<sup>10</sup> and "closed" (*cerradas*) ones. S.A.s that have issued public traded securities and S.A.A.s must be listed<sup>11</sup> on the Public Securities Market Registry (*Registro Público de Mercado de Valores*) and are subject to the following additional requirements:<sup>12</sup>

- They must comply with the regulations of the National Supervisory Commission of Enterprises and Securities (*Comisión Nacional Supervisora de Empresas y Valores* or CONASEV), including the Regulations on Financial Information (*Reglamento de Información Financiera* or R.I.F.<sup>13</sup>), which were last updated in 1999. The R.I.F. requires the application of IAS and any technical pronouncement by the accounting profession, incorporates some of the content of the IFRS conceptual framework and provides an overview of the content of explanatory notes to the financial statements.. A mandatory standard chart of account was issued by CONASEV in 1984 and is in the process of being revised in line with IAS in coordination with the CPN. CONASEV is empowered to issue accounting rules within the framework of Peruvian GAAP. It has used this

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<sup>6</sup> By corporate entities it is referred to enterprises of any size which do not belong to the financial (i.e. banking, insurance, brokerage, investment management, etc.) sector.

<sup>7</sup> Law 24680. Parts of the LSNC have been recently superseded by the General Law on Public Sector Financial Management (*Ley Marco de la Administración Financiera del Sector Público* or LMAFSP – Law 28112). Nonetheless, the role of the CNC in the field of private sector accounting standards has not been modified by the new law.

<sup>8</sup> The CPN is due to be renamed the National Public Accounting Department (*Dirección Nacional de Contabilidad Pública* or DNCP as part of the implementation of the LMAFSP. In addition to the CPN, the following public institutions are members of the CNC: Central Bank, Securities Commission (CONASEV), Banking and Insurance Superintendency (SBS), Tax Administration (SUNAT), Statistics Department (INEI), and State-Owned Enterprise Fund (FONAFE). Other members of the CNC are the Federation of Accountants (FCCPP), the Universities' Accounting Faculties (upon proposal of the National Assembly of Rectors) and the National Federation of Private Enterprises (CONFIEP).

<sup>9</sup> Resolutions 005-94 of March 1994 and 013-98 of July 1998.

<sup>10</sup> Law 26887 (LGS) – Article 249.

<sup>11</sup> In this report, "listed" is used to describe both companies with publicly traded securities and S.A.A.s.

<sup>12</sup> These requirements are also set in both the LGS and the Securities Market Law (*Ley de Mercado de Valores* or LMV) – Legislative Decree 861-1994.

<sup>13</sup> Resolution CONASEV 103-99-EF94.10. The R.I.F. along with all CONASEV regulation can be accessed through its website at [http://www.conasev.gob.pe/sil/sil\\_menu.asp](http://www.conasev.gob.pe/sil/sil_menu.asp).

- privilege only once in the past several years when it authorized the partial recognition of deferred tax and profit sharing liabilities over a period of 13 years;<sup>14</sup>
- Their annual financial statements must be audited. The R.I.F. requires that the audits should be performed in accordance with ISA and that auditors issue a special report to the securities commission if their audit report contains any form of qualification; the auditor is also required to follow-up on any qualifications in its subsequent reports;
  - Audited annual financial statements must be prepared as of December 31 of each year and presented to CONASEV by April 15 (for individual, parent company financial statements) and May 15 (for consolidated financial statements)<sup>15</sup> of the following year;
  - Unaudited quarterly financial statements of the first three quarters must be submitted within 30 and 45 days after the end of each quarter for individual parent company and consolidated statements respectively; for the last quarter they must be submitted within 45 and 60 days.
  - These annual or quarterly financial statements are published on CONASEV's website, together with management discussion and analysis of the year-end financial position and the related results of operations. The fact that this information is easily accessible to investors, other market participants and the public is a key contribution to the transparency of the securities market and the corporate sector as a whole.

9. **Currently there is no enforcement of financial reporting requirements for large non-listed companies and SMEs.** As suggested by its title, CONASEV's mandate originally included supervision of enterprises, irrespective of the fact that their shares were publicly traded or not. It had this responsibility until July 2000, when a law was passed<sup>16</sup> that restricted CONASEV's role to listed companies and capital market participants (mutual funds, brokers, etc.). Non-listed enterprises were thus no longer required to file their financial statements with CONASEV. The consequence is that investors and bankers were deprived of a broad range of information that allowed peer group financial analyses within a specific economic sector. This is seen by many agents in the financial system as an impediment to their investing or lending activities and ultimately hampers enterprises' access to capital.

10. **Banks, insurance companies and pension funds are required to present audited financial statements prepared in accordance with pronouncements of the Superintendence of Bank and Insurance (*Superintendencia de Banca y Seguros* or SBS) of 1996, or absent such pronouncements with IAS, and otherwise with U.S. GAAP.** Under the General Law of the Financial and Insurance Systems (*Ley General de los Sistemas Financiero y de Seguros* or LGSFS), banks and insurance companies are subject to a specific accounting and auditing regulatory framework set out either in the LGSFS or in SBS norms. Similarly, pension funds must comply with a specific act<sup>17</sup> and SBS resolutions. In particular, these entities are required to follow specific charts of accounts and accounting methods, as further discussed in chapter III. If listed (or "open"), the financial institution, insurance company or pension fund is required under Article 31 of the LMV to follow the norms set by SBS.

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<sup>14</sup> Resolutions CONASEV 168-98-EF/94-10 of 1998 and 110-99-EF/94/10 of 1999 – see paragraph 37 for further details.

<sup>15</sup> This departs from IAS 27, which requires that the consolidated financial statements should be issued contemporaneously with the legal entity financial statements. Ultimately, CONASEV should fully align the timetable for reporting at consolidated and individual/parent company levels.

<sup>16</sup> Law 27323 of July 2000, modifying Law 26126 on CONASEV.

<sup>17</sup> Law on Private Pension System (*Ley del Sistema Privado de Administración de Fondos de Pensión* or SPP) – Supreme Decree 054-97-EF.

11. **CONASEV has currently no control over the licensing of auditors of financial statements within Peruvian listed companies.** Until 2000, under article 260 of the LGS, independent audits within S.A.A.s could only be carried-out by one of the audit firms included on the Unified Audit Firm Registry (*Registro Único de Sociedades de Auditoría* or RUNSA)<sup>18</sup>. The RUNSA also served to qualify private sector auditors to conduct audits of public sector entities on behalf of Peru's Auditor General of the Republic (*Contraloría General de República* or CGR). However, as a result of a legal action filed in 1999 by representatives of the accounting profession in Lima, the obligation to be registered in the RUNSA was struck down on the ground of unconstitutionality.<sup>19</sup> Since then, the only requirement to audit financials statements of listed companies is to be registered as independent auditor within a college of accountant (see paragraph 15). As discussed in paragraphs 18 to 22, this process, over which CONASEV has no legal control, does not provide sufficient guarantees in terms of technical and professional competence of the practitioners licensed to conduct audits on the stock market. A system of public oversight of the audit profession would resolve this issue as further discussed hereafter.

12. **SBS Resolution 1042-99 sets certain basic requirements for external auditors to be appointed within banks and insurance companies.** The criteria for qualification include: adequate experience and capacity; not having been sanctioned by the SBS for non-compliance with rules on external audits or by any supervisory body for unsatisfactory work; and, not having any relationship with the company or related parties. The resolution also prescribes specific rules with respect to the audits of financial statements of banks and insurance companies. It states that external auditors must apply any specific auditing norm mandated by SBS and, for any other matter not addressed by SBS, generally accepted auditing standards (GAAS) or ISA. In terms of the scope of auditor's intervention, the resolution prescribes that they must prepare a report on (i) the system of internal controls as well as supplementary reports on specific matters prescribed by SBS, depending on the type of institution (e.g., for banks, detailed information on the breakdown of loans and receivables, on collaterals, etc.), and (ii) any "significant event" they may have identified. Article 9 of the resolution mandates the rotation of all members of the audit team after a period of five years.

13. **While the LGS gives formal power to designate external auditors to the shareholders, the law does not set forth any appointment or termination procedure.** Auditors are appointed for periods of one fiscal year, renewable each year. In practice the decision to appoint or terminate auditors is mostly exercised by the Board of Directors. Both CONASEV and SBS require any decision to change external auditors to be promptly notified to them with adequate justification. Nonetheless, the role of regulators cannot be a substitute for proper governance mechanisms that ensure the independence of external auditors for the benefit of stakeholders.

14. **Audited financial statements of listed companies and other entities of public interest are easily accessible by investors and the public.** CONASEV's website contains full copies of annual audited as well as quarterly financial statements of all the entities under its supervision. Banks, insurance companies and pension funds are required to publish the same in two newspapers of national circulation.

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<sup>18</sup> Created in 1996 through Legislative Decree no. 850.

<sup>19</sup> Unconstitutionality was found to exist due to the RUNSA's four categories of auditors which by the Court found to be discriminatory.

## B. The Accounting Profession

15. **The accounting profession in Peru is organized through the 25 regional colleges of public accountants (*colegio de contadores públicos*), is regulated by a specific act and represents a membership of an estimated 70,000 *contadores públicos*.** The colleges, or associations,<sup>20</sup> of accountants were established as self-regulated organizations under the Law on Professions (*Ley de Profesionalización*) of 1959 and enjoy certain privileges under article 20 of the constitution.<sup>21</sup> Any practicing accountant must be affiliated with one of them. The largest one is the College of Public Accountants of Lima (*Colegio de Contadores Públicos de Lima* or CCPL), which has an estimated 31,000 affiliates and exercises a strong influence over the profession countrywide.

16. **The activities of the colleges of accountants are mostly geared toward the defense of their members.** Each *colegio* operates under its own rules. The *colegio* of Lima is governed by its By-laws (*estatutos*, issued in October 1998) and Regulations (*reglamento interno*, August 1999). These provide for two main governing bodies, the general assembly and the managing board (*consejo*). The By-laws also provide for various auxiliary bodies including the Tribunal of Honor and the ethics committee—whose roles are limited at the moment (paragraph 21). The By-laws set forth the objectives of the college of accountants, which are to: ensure that professional practice is in accordance with mandated principles and standards; issue<sup>22</sup> and disseminate accounting standards; cooperate with public authorities; develop relationships with national and international accounting organizations; and promote the continuing education of its affiliates. The *colegio* is mandated to represent and defend the profession, to investigate cases of illegal practice or alleged professional ethics violations by members, as well as to regulate professional accounting practice. For the most part however, the By-laws and Regulations—which essentially repeat each other—deal with the practical details of how the *colegio*'s various bodies and committees are formed and other matters, but do not set out precise procedures or guidelines under which the *colegio* is to pursue its stated objectives and mandates on issuance and dissemination of accounting standards or continuing education for its membership. The managing board and its President or Dean (*Decano*) are elected every two years by *colegio* members.

17. **As is traditional in most of Latin America, the only substantial requirement for affiliation with a *colegio* is the title of *contador público* awarded by any university.** In the case of the *colegio* of Lima, Article 6 of the Regulations states that in order to be granted affiliation candidates must present their professional title along with proof of five years of studies. Once admitted, members must fulfill certain annual training requirements that are discussed in paragraph 27 hereafter.

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<sup>20</sup> These professional bodies have no affiliation with any university or other academic institutions, although they may organize courses in the field of accounting. They are referred to as “colleges of accountants” or “*colegios*” in this report.

<sup>21</sup> These privileges include setting the professional ethics code (see paragraph 21) and maintaining registry of public accountants. Certain specific provisions that apply to accountants under the Law on Professions are also set in Presidential decree (*Decreto supremo*) no. 28 of August 1960.

<sup>22</sup> Although under the Law the CNC is the official accounting standard-setting body.

18. **The colleges of accountants keep separate registries of auditors who, once registered, are automatically qualified to conduct audits of listed companies.** The Regulations of the *Colegio* of Lima establish that it should maintain two separate registries for those individual auditors or audit firms<sup>23</sup> who seek to perform external audits of financial statements. To be registered as individual auditor, public accountants must satisfy the following conditions: a) have a minimum of five years of affiliation with the *colegio*; b) have attended specialized courses given by the *colegio*, universities or qualified training institutions; and c) provide evidence of continuing professional education (CCPL Regulations, Article 158). As for audit firms, they must be incorporated as partnerships (*sociedad civil*), all partners being affiliated public accountants, and they must comply with “international and accounting norms auditing manuals and the minimum procedures approved by the National Congresses of Public Accountants in Peru”.<sup>24</sup> In fact, the only requirement for accountants to retain their membership in a *colegio* is to pay membership fees. Once admitted, members of a *colegio* can use a special professional title (*contador público colegiado*, or CPC), although in reality they may have no more qualification than any *contador público* who is not affiliated with a *colegio*. The existence of different titles that do not represent differences in levels of qualification is unwarranted as it creates either confusion or undue appearance of professional competence.

19. **The Federation of Colleges of Public Accountants of Peru (*Federación de Colegios de Contadores Públicos del Perú* or FCCPP) is an umbrella organization which has some accounting and auditing standard-setting powers but plays a relatively limited role.** The primary responsibility for regulating the accounting profession lies with the *colegios*. The role of the FCCPP as a federal body is twofold: coordination at the national level and representation in international fora on the one hand; and monitoring accounting and auditing standard-setting on behalf of the profession.<sup>25</sup> on the other hand. The FCCPP is a founding member of the Inter-American Accounting Association (*Asociación Interamericana de Contabilidad* or AIC). It is a member of the International Federation of Accountants (IFAC) since 1984, although on the list of members posted on IFAC’s website FCCPP is mentioned as “suspended”<sup>26</sup> and actually has had very limited involvement with IFAC to this date. FCCPP’s President is elected by the Deans of the 25 colleges of accountants, each *colegio* having voting powers proportional to its number of affiliates. Every two years, the FCCPP organizes the National Congress of Public Accountants for all members of the *colegios*. The National Congress has endorsed the translation of ISA and their two subsequent updates prepared under the aegis of the FCCPP from 1996 and 2000 (the latest update was based on the 1998 release of IFAC’s Handbook containing the version of ISA and other technical pronouncements prevailing at the time).

20. **The largest audit firms have created a collegial body to harmonize their positions on accounting and auditing issues in the country.** Established in the late 1970s, the Institute of Independent Auditors of Peru (*Instituto Peruano de Auditores Independientes* or IPAI) is a not-for-profit organization grouping some 40 firms including those with international affiliation who normally interact with public bodies such as CONASEV and the CGR to discuss technical accounting and auditing issues. IPAI was created to fill what was perceived by these audit firms

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<sup>23</sup> In the case of Lima, there are currently 700 accounting firms licensed to conduct audits by the CCPL.

<sup>24</sup> Article 155 of CCPL’s Regulations provides a one-page, description of these requirements which include generic concepts such as: adequate technical training and knowledge in accounting and auditing, independence, profession care, planning and adequate supervision, studying and evaluating internal controls, etc.

<sup>25</sup> Through ad-hoc groups of CPCs (see paragraphs 28 and 30 on accounting and auditing standards respectively). FCCPP is a member of the accounting standard-setting body (CNC).

<sup>26</sup> Out of the 158 member organizations listed on IFAC’s website, 5 were suspended. Suspension normally indicates that the member organization has not settled its membership fees. We understand that the FCCPP and IFAC have reached an agreement with a view to resolve this situation before the end of 2004.



as a vacuum within the profession.

21. **The accounting profession has adopted an ethics code which is substantially less demanding than IFAC's Code of Ethics for Professional Accountants.**<sup>27</sup> A Code of Professional Ethics was initially developed by the CCPL in 1959. It was then adopted by the National Congress of Accountants in 1984 and later updated by the FCCPP in December 1998. It is an eight-page document containing six sections dealing with: 1) Scope, 2) General Standards of Ethics, 3) Standards for Practitioners (accountants in public practice or in business), 4) Compensation, 5) Advertising, and 6) Violations and Sanctions. Compared to IFAC's code (revised November 2001), it is much less detailed and does not adequately address several critical aspects of the audit practice including: a) the public interest as a distinguishing mark of the accountancy profession; b) professional competence and due care—the FCCPP/CCPL code refers to professional responsibility but fails to define it; c) the concept of independence and the related threats and safeguards, for which no guidance is provided by the FCCPP code, while IFAC's code has seven pages plus several illustrative examples on the matter. Moreover, with regards to the issue of conflict of interest, Article 36 of the code of ethics prohibits accountants who provide bookkeeping services through outsourcing arrangements from carrying out audits at the same time. The code, however, does not forbid auditors from providing other types of services that are increasingly regarded as incompatible with the function of independent auditor, such as: other types of accounting services, the design and implementation of information systems, or the valuation of assets. Also, the lack of explicit prohibitions can cause misunderstanding on the part of practitioners and make it more difficult for the colleges of accountants to exercise sanctions, or for plaintiffs to claim before a Court that auditor independence has been breached.

22. **The colleges of accountants do not actively enforce their codes of ethics.** Under Section X of the CCPL's By-laws, cases of violation of the Code of Professional Ethics are to be reviewed by an ethics commission. After a period of 30 days, the commission must notify the results of its investigation to the board, who can then decide to bring the case to the Tribunal of Honor.<sup>28</sup> The latter must then render a decision within 30 days, subject to appeal (*reconsideración*) before itself. The sanctions the Tribunal can impose are provided for in the Code of Professional Ethics (article 54). They include admonition, suspension for one to 24 months, or revocation. However, there are no procedures to enforce the provisions of the ethics code and in fact there are very few known cases of sanctions. One issue that was brought to the attention of the ROSC team is the fact that, although Article 33 of the ethics code specifically prohibits an auditor from issuing an opinion on financial statements that have already been audited by another practitioner, such cases are not uncommon.<sup>29</sup> The lack of active enforcement of the ethics code—despite the fact that Article 5 of the *Ley de Profesionalización* explicitly requires such enforcement—can be explained by the fact that the Colegios' leadership is elected by the membership, which creates a negative incentive. It raises serious concerns as to the

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<sup>27</sup> It should be noted that no other ethical requirements have been set by CONASEV, SBS or CGR, except for the requirements of the RIF (Articles 45 on independence and 51 on confidentiality). The Principles of Good Governance for Peruvian companies issued by an ad-hoc committee led by CONASEV includes certain guidance regarding auditors.

<sup>28</sup> Both the Tribunal of Honor and ethics commission have each five members appointed by the managing board for periods of two years, respectively among former deans and vice-deans, and any *colegio* affiliate.

<sup>29</sup> Such broad prohibition does seem appropriate, as it puts undue restriction on financial statement users' ability to request a new audit when they consider the reliability of a previous audit to be questionable. The intent of Article 33 was to prevent companies whose auditors had issued a report with a qualified opinion from obtaining a more favorable opinion from another auditor. A more proper way to address this concern would to have a quality control system in place that would ensure all licensed auditors comply with IAS.

effective compliance by practitioners in Peru.

23. **In the current circumstances there are various factors constraining the accountability of auditors with regards to investors and other stakeholders.** First, the auditors are not required to take out professional indemnity insurance, and only the large international firms appear to have subscribed such insurance. This type of insurance facilitates financial statements users' recourse against errant auditors. Secondly, Peru's company law (LGS) does not provide for sanctions against errant auditors, nor does the country's legal tradition facilitate lawsuits against them.<sup>30</sup> Indeed, the use of such remedies for users of audited financial statements is very uncommon and there are no known cases of civil lawsuits against auditors in Peru. Finally, auditors' accountability vis-à-vis CONASEV and SBS has been substantially reduced since the RUNSA registry has been judged invalid, effectively taking away from the regulators the power to sanction auditors by barring them from professional exercise.

24. **The market of audit services to listed companies and financial institutions is dominated by the local affiliates of the "Big-4" networks.** Currently, almost all companies listed on the stock exchange of Lima—which, under the Law, include banks, leasing or insurance companies, and pension funds—are audited by one of the "Big-4" firms Peruvian affiliate<sup>31</sup>—a result of local or international market trends, over which Peruvian regulators have little influence. Savings and loans institutions are mainly audited by medium-sized firms. There are no statistics available regarding the market of audit services to non-listed, non-financial institutions in general, although a number of small-to-medium sized firms appear to have developed a significant presence on the market.

### C. Professional Education and Training

25. **The university curricula leading to the title of public accountant in Peru are not harmonized with each other and are generally not current with respect to international best practice and IFAC's education standards.** Under the constitution, Peruvian universities are fully autonomous in designing their academic curricula and examinations. All universities have an accounting curriculum, mostly integrated with economics and business administration curricula. The degree of *contador público* is generally of graduate level (*licenciatura en contaduría pública*). Due to the autonomy of universities and a lack of cooperation among them as most see each other as competitors, no substantial effort has been made to harmonize the accounting curricula and establish minimum requirements in terms of type and content of courses on accounting and auditing. As a result, the title of public accountant does not reflect the same content and quality from one university to another. "Big 4" audit firms tend to recruit graduates from the three leading universities in Lima, whose reputations are good among authorities, the business community and the public.<sup>32</sup> Indeed, these universities have developed accounting

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<sup>30</sup> Articles 1318 to 1320 of Peru's Civil Code provide legal ground for lawsuits against practitioners, although plaintiffs must demonstrate the existence of a fraud or faulty actions. Under Article 1329, serious negligence leading to damages to third-parties constitutes an inexcusable fault (*culpa inexcusable*). The CPN has issued a Resolution (no. 008-97-EF/93.01) in 1997 defining non-observance of ISA and the ethics code as cases of inexcusable fault.

<sup>31</sup> For the fiscal year ended December 31, 2003, almost 70% of listed companies that have published their financial statements were audited by one of the "Big 4", and 10% by the Peruvian affiliate of another large international network. 30 accounting firms audited the remaining companies (source: CONASEV).

<sup>32</sup> A survey of parents conducted by the private firm *Apoyo Opinión y Mercado S.A.* in October 2002 ranked Peruvian universities in the fields of economics, business administration and accounting. *Pacífico*, *Católica* and *Lima* were considered the best in the field of accounting by respectively 24, 20 and 16% of parents surveyed. It should be noted that these universities have developed international agreements mainly for exchanges of students.

courses that give adequate focus on financial reporting objectives, principles and practices, with adequate international perspective, and do not limit themselves to the teaching of bookkeeping. Nonetheless, since the small and medium accounting practice does not typically recruit out of these leading universities, this is an impediment to their access to adequately skilled recruits and to their capacity to provide quality services to SMEs. Finally, the various universities interviewed have little involvement with the international professional accounting organizations; for example, they do not subscribe to the IASB's publications and they have not made attempts to implement IFAC's recommendations regarding accounting and auditing education.

**26. The colleges of accountants do not require any professional examination for registering a professional accountant as independent auditor, nor do they ensure that would-be auditors have acquired sufficient practical experience before being awarded the auditor's license.** To obtain initial registration, CCPL's Regulations require that practitioners demonstrate only that they have acquired five years of affiliation and attended training courses on auditing (paragraph 18). Meeting these requirements does not necessarily mean that one has been sufficiently prepared to perform an audit. Consequently, the license of auditors may in certain cases be awarded to persons who have not acquired sufficient technical knowledge and professional skills, whose audits may therefore not be of adequate quality.<sup>33</sup>

**27. Colleges of accountants theoretically require continuing education on the part of their members, but these requirements are neither enforced nor complied.** In the case of the Lima *colegio* (CCPL), under article 14 of CCPL's Regulations, affiliated public accountants must dedicate 30 hours per year to continuing education activities that include participation in training courses, seminars or other events organized by the *colegio*, such as annual meetings and other events of a social nature, and involvement in the technical commissions of the *colegio*. Such requirements are fairly vague, and to date the implementation of continuing education courses has been limited. No procedures are in place within the colleges of accountants to ensure that they are appropriately complied with—and in effect they are not applied. Thus, there is no guarantee that licensed auditors have adequately updated their professional capabilities in order to fulfill their responsibilities. Since the profession is unable to enforce members' training obligations as set in its own Regulations, a solution would be that the regulatory agencies (i.e., CONASEV, SBS) introduce their own training requirements for accounting practitioners to be authorized to conduct statutory audits. The practitioners would see an incentive to submitting themselves to that obligation in the increased recognition this could bring to them from authorities and the business community. DNCP and CNC in their capacity of standard-setters should be associated with all matters involving continuing education and quality assurance of the professional practice.

#### **D. Setting General-Purpose Accounting and Auditing Standards**

**28. The accounting standard-setting process for general-purpose financial reporting in Peru is one that is clearly defined, actively monitored by the CPN, and involves all concerned parties.** Under the LMAFSP,<sup>34</sup> the CNC is empowered to set the accounting principles to be applied pursuant to the LGS, commonly referred to as Peruvian GAAP (paragraph 35). Two key characteristics of the CNC are its wide membership and the fact that a

<sup>33</sup> In this regard, IFAC has recently issued several International Educational Standard (IES) which deal in particular with questions of professional accounting education programs (IES 2) and practical experience requirement (IES 5). On the latter issue, the standard requires that "the member body (...) ensure that the practical experience candidates have gained is acceptable" (IES 5, paragraph 18).

<sup>34</sup> Formerly the LSNC (paragraph 7).

large majority of its members are from public sector entities.<sup>35</sup> Under the leadership of the CPN and with the cooperation of CONASEV, the profession and other interested parties, the CNC has had commendable achievements in improving accounting standards in Peru. These improvements culminated with the official adoption of IAS as a whole in 1998.<sup>36</sup> The process of adopting the international standards and related interpretations involves the following steps: a) experienced Peruvian accounting professionals are designated to assist in translating recently promulgated standards into Spanish; b) the draft Peruvian standard<sup>37</sup> prepared is then circulated within the CNC and the profession for review and comments; c) after the review process, the draft NIC standard is formally approved by the CNC; and d) finally, the approved standard is notified to the FCCPP for communication within the accounting profession. In certain cases, to allow sufficient time for the dissemination of the standard and training by preparers and auditors, the CNC may decide that the effective date of the standards be one or two years later than that of the corresponding official IAS standard.<sup>38</sup> It should be noted that the translation process in Peru does not involve any consultation with accounting organizations in other Spanish-speaking countries, which may lead to some inconsistencies with other existing Spanish translations of IAS.

29. **The IAS adoption process is somewhat hindered by CNC's scarce resources.** Once promulgated, each individual translated IAS (NIC under the equivalent Spanish acronym) is published by the CPN together with some illustration guidelines and examples of how to apply parts of the standard. For its part, the FCCPP publishes the full text of the NICs promulgated in Peru together with translated SIC interpretations. However, the publication of the standards has been suffering delays and, at present, the latest updated version of the NICs has been released in October 2002.<sup>39</sup> One of the problems faced by Peru's authorities, financial community and accounting profession is the difficulty for the CNC to cope with the pace at which standards and interpretations are being issued or re-issued by the IASB. This causes significant delays in the availability of the Spanish translations of IASB pronouncements, stretching sometimes to several years. In some cases these delays have led the CNC set the first application date way beyond the date set by IASB or its predecessor IASC.<sup>40</sup>

30. **ISA have been officially endorsed by the profession and regulators, but their full implementation is hindered by the lack of institutional capacity of the profession's representative bodies.** In 1993, a full translation of IFAC's Handbook of Technical Pronouncements (containing auditing standards and practice statements as of 1992) was published in Peru by a group of professionals belonging to the *colegio* of Lima, on behalf of the *colegio*. The translation was updated twice since then, first in 1996, and then in 1999. The latest available Spanish-language version<sup>41</sup> has been published in May 2000 and corresponds to the

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<sup>35</sup> Among the current 16 members of the CNC, 12 represent public entities (DNCP, Central Bank, CONASEV, SBS, tax authorities, etc.). The accounting profession is represented by the FCCPP and the CCPL and universities and the business community have one representative each.

<sup>36</sup> The first adoption of pronouncements by the IASC (IAS 1 to 29) occurred in March 1994. In July 1996, IAS 30, 31 and 32 were adopted. The process has continued after 1998 and to this date all IASs up to IAS 41 have been adopted.

<sup>37</sup> Referred to as "NIC" (*norma internacional de contabilidad*).

<sup>38</sup> For instance, IAS 39 issued by the IASC was applicable as from January 1, 2001, while the application of its translation in Peru (NIC 39) was mandatory only as from January 1, 2003.

<sup>39</sup> This latest version of the NICs corresponds to the full text of IAS 1 to 41 prevailing in 2001 and Interpretations 1 to 25 of the IASC's Standing Interpretation Committee (SIC, replaced by the International Financial Reporting Interpretation Committee, IFRIC since 2001). See also section III hereafter.

<sup>40</sup> For instance, amendments to IAS 12, 19 and 39 approved by the IASB in 2000 were translated into Spanish in 2002; SIC 27 to 33 issued between February 2000 and August 2001 were translated in 2003.

<sup>41</sup> The translation of the handbook is entitled "Normas Internacionales de Auditoría NIAs". Contrary to IFAC's, it does not mention which year it was last updated on its cover.

1998 version of IFAC’s Handbook. These translations have been officially endorsed by the accounting profession’s representative bodies (CCPL and FCCPP’s National Congress of Accountants and Board).<sup>42</sup> Nevertheless, auditors still use the expression “generally accepted auditing standards in Peru” in their reports,<sup>43</sup> which reduces the value attributed to these reports by international users, who place greater reliance on international standards than on local ones.

### **E. Enforcement of Accounting and Auditing Standards**

31. **CONASEV is legally empowered to enforce financial reporting standards but does not have sufficient resources to monitor listed companies’ compliance with IAS in a proactive and comprehensive manner.** The act of CONASEV of 1992 as amended 2000 entrusts the securities regulator with “issuing the standards for preparing and presenting individual and consolidated financial statements and whichever additional financial information (...) of the entities falling under its supervision, in accordance with accounting standards applicable in the country, as well as verifying their compliance.”<sup>44</sup> However, due to its limited resources, CONASEV does not presently have sufficient staff to enforce financial reporting requirements on listed companies including application of IAS, and is insufficiently staffed. Civil servants within the Commission, who have accounting expertise, are in charge of reviewing all financial information relating to listed companies. It investigates mostly cases of denunciations or blatant departure with IAS or other financial reporting requirements.<sup>45</sup> CONASEV does not conduct inspection of audit firms to monitor compliance with accounting and auditing standards.

32. **In the financial sector, the SBS mostly relies on its own processes and resources as well as on internal auditors for enforcing financial reporting requirements.** The SBS, through its three sector-specific divisions,<sup>46</sup> conducts off-site reviews and yearly on-site inspections of the entities under its supervision. It has developed its own auditing tool and monitors compliance with the accounting manual’s registration, classification and valuation rules. It reviews the reports issued by external auditors pursuant to Resolution no. 1042-99 and applicable legislation, but tends to place much more reliance on internal auditors. Nonetheless, the SBS’ supervision would benefit from greater emphasis on the work of external auditors, as their objectives are relevant to the regulator’s mission.<sup>47</sup>

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<sup>42</sup> The NIA Handbook contains two statements, one by the CCPL’s Special Technical Committee on Auditing Standards and another by the Board of FCCPP, which approve the use of NIA (translated IAS) as auditing standards in Peru, their publication and dissemination to the profession. ISA also received CNC’s official backing in 1997.

<sup>43</sup> See paragraph 42 hereafter.

<sup>44</sup> Ley Orgánica de CONASEV (Law 26126) – Article 2 k.

<sup>45</sup> CONASEV’s annual report for the year 2002 mentions that the Commission carried-out “selective evaluations of 227 annual reports” and eight inspections at five companies. Inspections for two of these companies involved issues of financial reporting (audited financial statements not submitted). The report indicates that the evaluation of audited financial information “detected some inconsistencies in the application of IAS and cases of insufficient disclosure of information”. One auditor was inspected with regards to the 1999 financial statements and a sanction was taken against the auditor for lack of support of the inventory accounts. CONASEV’s report on the year 2002 is available to the public at <http://www.conasev.gob.pe/Acercade/Memoria.pdf>.

<sup>46</sup> *Superintendencias Adjuntas* (Banks, Insurance, and Pension Funds).

<sup>47</sup> The Basel Committee on Banking Supervision has issued a paper that provides guidance on this issue (*The Relationship Between Banking Supervisors and Banks’ External Auditors* – Publication no. 87, January 2002, prepared in association with IFAC, who incorporated its content in International Auditing Practice Statement 1004).

33. **The accountancy profession's self-regulating bodies do not enforce auditing standards.** The FCCPP or the local colleges of accountants have not put in place any mechanism to enforce the effective application of ISA, especially the quality control requirements set out in ISA (or NIA) 220, *Quality Control for Audit Work*. The only quality assurance arrangements that exist in the profession are those applied on a voluntary basis mainly by those firms affiliated with large international networks. Neither the *colegios* nor the FCCPP monitors these procedures.

34. **CONASEV and SBS have sanctioning powers against auditors although they seldom exercise these powers.** Under the Act on CONASEV of 1992, the securities commission can impose sanctions on auditors. CONASEV has issued a Resolution on Sanctions<sup>48</sup> which provides for several types of penalties against “any act or omission which affects (...) the equal access to or timeliness of the information (...)” Such penalties include: admonition; fine of 1 to 300 *unidades impositivas tributarias* or UIT (equivalent to approximately US\$900 to 275,000); suspension; or cancellation of license. However, the latter two cases do not apply to auditors since CONASEV is no longer empowered with licensing auditors. Similarly, SBS issued a resolution on sanctions (no. 310-98) which foresees various types of infringement of the law on the part of auditors such as breach of confidentiality, technical deficiency, providing false, or erroneous information. The sanctions SBS can inflict are fines of up to 100 UIT (equivalent to approximately US\$90,000). However, it cannot revoke auditing licenses. In any case, sanctions against auditors in the private sector have been sporadic. With regards to the state-owned sector, the CGR has more effective sanctioning abilities since it directly hires auditors and it is entitled to keep its own registry of authorized auditors.

### III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

35. **As a result of the application of CNC Resolution no. 013-98, Peruvian GAAP correspond to a Spanish translation of IFRS, with some differences mainly due to the time needed for translation.** As of the date of this report, all 34 IAS standards and 32 interpretations are applicable in Peru, as well as the latest version of the *Framework for the Preparation and Presentation of Financial Statements*.<sup>49</sup> One of the differences has to do with the treatment of inflation in Peru. Until recent years, Peru, as well as a number of countries in Latin America, experienced high levels of inflation. In order to eliminate the effects of high inflation on the financial statements, and as provided by international accounting standards,<sup>50</sup> companies in Peru had been applying the price level adjustment method for many years. However, since the middle of the last decade, inflation in Peru has dramatically decreased, reaching 2.3% in 2003.<sup>51</sup> Although, under NIC (i.e. IAS as translated and made official by the CNC), the practice of restating financial statements for the effects of inflation was no longer permitted, the CNC decided to maintain its application, mainly because it considered that the method was still best suited to meet the needs of financial statement users in Peru. And only very recently, after the stabilization of price levels appeared to be long lasting, did it decide to phase out this practice.<sup>52</sup>

<sup>48</sup> Resolution 55-2001-EF/94.10 of October 2001.

<sup>49</sup> Although, because the most recent version of the *Framework for the Preparation and Presentation of Financial Statements* issued by IASC was only recently adopted by CNC, the one included in the latest issue of the NICs published by FCCPP corresponds to the original text published in 1989.

<sup>50</sup> IAS (or NIC) 29, *Financial Reporting in Hyperinflationary Countries* is the standard that provides for the application of price level accounting. IAS 29 provides five criteria to assess whether a country is in a situation of hyperinflation, thereby warranting inflation adjustment. Among those criteria is the fact that inflation would reach an accumulate level of 100% over the previous three-year period.

<sup>51</sup> Source: Economist Intelligence Unit (consumer price inflation – average). Consumer price inflation (year-end) was 3.7% in 1999 and 2000, -0.1% in 2001 and 2.1% in 2002.

<sup>52</sup> CNC Resolution no. 031-2004-EF/93.01, May 2004. *Subsequently, through Law no. 28304 published on November 23, 2004, price level accounting for tax purposes was suspended, effective in 2005.*

This recent decision by the CNC is positive insofar as it eliminates one of the existing factors preventing the unambiguous and explicit reference to IFRS in Peruvian companies' financial statements and independent auditors' corresponding reports.

36. **Despite the fact that IFRS have been officially adopted by Peru, published general-purpose financial statements of enterprises and the corresponding audit reports still refer to “Peruvian GAAP”.** Apparently due to the fact that the NIC standards applied in Peru lag behind IFRS and differ with them on the issue of inflation accounting, preparers, auditors and regulators consider that the financial statements produced are not compliant with IFRS. For instance, in the notes to general-purpose financial statements, accounting policies are commonly referred to as “Peruvian GAAP, which include IAS as officially recognized by the CNC”. Although in substance most IFRS are effectively applicable in Peru, this presentation is technically accurate. Nevertheless, the reference to a national GAAP reduces the positive impact for Peru of having harmonized its accounting standards with international ones.<sup>53</sup>

37. **In the late 1990s, CONASEV issued a resolution allowing an accounting treatment that departs from IFRS.** As a consequence of the adoption by CNC of IAS 12, *Income taxes*, Peruvian companies would normally have been required to recognize all deferred tax assets and/or liabilities<sup>54</sup> as measured at December 31, 1998. However, during the year 1998, CONASEV, through resolution 168-98 (which was extended in 1999 by resolution 110-99), authorized its registrants to spread the recognition of such deferred tax assets or liabilities year after year over a period of 13 years from 1999 onwards. This measure was taken with the objective to avoid situations where companies would have had to show significant reductions in equity. Instead, it provided for a transition period as a way to smooth the effect of the adoption of a stricter accounting rule on these elements of the financial statements. This special rule is still in force and is still having a material impact on the financial statements of certain companies listed on the BVL. For instance, in the case of one of the companies included in the ROSC review of financial statements, the amount of unrecognized liability as of December 31, 2002 represented approximately 10% of the company's equity. This is the only instance where CONASEV allowed for a treatment that contradicts IAS—which by contrast shows that CONASEV's commitment to endorse IAS has been strong. Nevertheless, it sets a regrettable precedent, potentially damaging the trust of investors in companies and regulators.<sup>55</sup> It should also be mentioned that CONASEV would not be able to issue rules contrary to IFRS as the one it issued in 1998, because Law 27,323 of July 2000 requires that any CONASEV-issued accounting rule comply with the conceptual framework of Peruvian accounting principles (i.e., with the IFRS *Framework*).

38. **There are substantial differences between accounting standards applied by banks and insurance companies for general-purpose financial reporting and IFRS.** Based on the

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<sup>53</sup> CONASEV has indicated that, as part of the updating of the RIF, which is due to take place in the near future, consideration would be given to requiring financial statements and auditors' opinions to refer to IFRS. This would require that the CNC be able to update all NICs in line with IASs as amended by IASB in the recent period and to adopt all IFRSs issued by the IASB (for example, IFRS 1, 2 and 4 were adopted in 2003 and 2004 and will become effective on January 1, 2004 or 2005).

<sup>54</sup> i.e., latent tax benefits or expenses relating to elements of the financial statements that had not given rise respectively to taxation or deductibility, due mostly to differences between tax rules and accounting standards.

<sup>55</sup> According to CONASEV, this measure was necessary to avoid negative impacts on financial statements of companies that had attracted investors in certain sensitive sectors; also, the residual amount of unrecognized deferred tax liabilities at present is deemed immaterial by CONASEV—although the ROSC review found two cases where the effects of this exception to IFRS were still significant in 2003. In the first case, the effect on the 2003 net income and on the equity at December 31, 2003 were respectively -14% [reduction] and 6% [increase]; in the other case, the impacts were respectively a reduction of net income by 12% and an increase of equity by 8%.

SBS Accounting Manual applicable as from 2001 to financial institutions and on the notes to the consolidated financial statements of banks reviewed by the ROSC team, several differences in the measurement of assets and the way certain losses are recognized became clear. For instance, provisions for impairment of loans include a generic provision based on a compulsory matrix issued by the SBS.<sup>56</sup> This matrix provides for provisioning rates to be applied to the various categories of loans contemplated by the matrix (consumer v. others; guarantees v. no guarantees; fixed v. variable interest; etc.). Such an approach may lead to significantly different values than those that would have been obtained applying IAS 39, *Financial Instruments: Recognition and Measurement*.<sup>57</sup> Another area of discrepancy is the valuation of investment securities. Under SBS Resolution no. 1053-99, “available-for-sale” securities must be valued at the lower of cost and market value, while under IAS 39 they must be measured at fair value. Moreover, SBS has authorized several banks to apply special accounting treatments that do not comply with IFRS. For instance, in a Circular issued on December 31, 2002, SBS allowed the country’s three largest banks to recognize losses on loans, securities investments or other types of assets for a very material amount (over 80% of the equity in the case of one bank) directly as a debit to equity, when under IFRS and the accounting principles generally applied in most countries these losses should have been recognized as an item of the income statement.<sup>58 59</sup> As confirmed by certain financial statement users (paragraph 43), these accounting treatments that depart from the general accounting rule do not foster confidence in the truthfulness of the financial statements of these entities, which can adversely impact the development of Peru’s securities market.<sup>60</sup>

**39. The review of a sample of financial statements indicates that Peruvian corporate entities still do not fully comply with IFRS and that they need further training for applying the standards.** The ROSC review of sample general-purpose financial statements as of December 31, 2002 covered 20 Peruvian public interest entities, including four banks, all of which listed on the stock exchange except for one large state-owned enterprise. The main areas where the level of compliance needs improvement are the following:

- *Disclosure of accounting policies* (IAS 1, IAS 28) –The description of accounting policies applied was incomplete or sometimes too generic. For example, impairment of assets was not mentioned as a policy followed in the valuation of property, plant and equipment. Other cases related to leases, revenue recognition, use of estimates, contingent liabilities, and correction of errors. In one set of financial statements the notes specified that the company had an investment in an affiliate which it carried at historical cost, in spite of having a percentage of interest clearly indicative of significant influence. Under IAS 28, *Accounting for Investments in Associates*, the investment should either have been valued using the equity method, or the notes should have provided an adequate justification of the absence of significant

<sup>56</sup> SBS Resolution no. 808-2003.

<sup>57</sup> IAS 39 require loans to be valued on the basis of the present value of expected cash flows.

<sup>58</sup> SBS indicated that Article 64 of the LGSFS empowers it to authorize the reduction of share capital to offset this type of provisions. The wording of Article 64 indeed indicates that the law allows reducing the share capital “for the amount of deficit in provisions vis-à-vis the requirements of the Superintendency”.

<sup>59</sup> The presentation of accounting principles applicable to banks in the notes to the financial statements and in the corresponding auditors’ reports is somewhat unclear. The ROSC review of published financial statements of banks identified four different wordings, including “Peruvian GAAP applicable to financial institutions”, “Peruvian GAAP which substantially include standards issued by the SBS and, where applicable, IAS as officially recognized by the CNC”, etc.

<sup>60</sup> This particular situation would not be possible any longer as Resolution no. 83-2003 requires that provisions be recognized through the profit and loss statement (Chapter III, section 8). Nevertheless, it is advisable that, in the future, in using its standard-setting discretionary powers, SBS should not generate discrepancies with internationally accepted general standards.



influence.

- *Consolidation (IAS 27)* – There were two cases of exclusion of a subsidiary from the scope of consolidation on the basis of criteria that are not in accordance with IAS 27, *Consolidation and Investment in Subsidiaries*.
- *Provisions, Contingent Liabilities and Contingent Assets (IAS 37)* – The explanatory notes were not complete and could prevent the reader of the financial statements from properly assessing the consequences of a contingency due to missing information. In one case, a company had recognized a receivable on the balance sheet that, from the description provided in the notes, had the characteristics of a contingent asset (which is expressly prohibited by IAS 37 paragraph 31—such type of asset should instead be disclosed, if the corresponding expected inflow of economic benefit is probable).
- *Segment Information (IAS 14)* –Financial statements should contain this type of information, so that users can gain a proper understanding of the company’s economic performance.
- *Related-party relationships and transactions (IAS 24)* – Dealing with a sensitive issue for non-controlling shareholders, the information on outstanding amounts and pricing policies with respect to related-party should be complete and transparent.
- *Intangible assets (IAS 38)* – The ROSC review noted that a bank had capitalized advertising costs, and another one had deferred start-up costs over a period of five years. These types of cost are not eligible for capitalization under IAS 38 and are generally treated as period expenses in most countries.
- *Financial instruments (IAS 32 and 39)* –Companies should properly disclose the required information on financial risks and on company risk management policies. Moreover, in the case of three sets of financial statements as of December 31, 2002, the explanatory notes indicated that losses in relations to financial instruments had not been recognized in these financial statements. The rationale for not recognizing such losses was that the standard dealing with this specific matter (IAS 39, *Financial instruments: Recognition and measurement*) was not mandatory in Peru at the time. Nonetheless, in light of the information provided in these footnotes, there was a strong indication that the losses should have been recognized under the general principles set in the *Framework for the Preparation and Presentation of Financial Statements*.
- *Income taxes* – In evaluating the deferred tax liability as of December 31, 2002, a company failed to consider certain elements necessary for an accurate computation of such liability, resulting in their under-statement by a material amount. This issue gave rise to a qualification in the audit report as of that date. In 2003, as recommended by IFRS, this error was corrected through a reduction of the equity (i.e., not as a element of net income). Yet the company did not restate the comparative information (balance sheet and income statement) as required by IFRS.<sup>61</sup>
- On several other aspects (borrowing costs, leases, discontinuing operations, date of approval of the financial statements, etc.) the disclosures were sometimes incomplete, which may prevent the financial statements from providing a fully meaningful and accurate information to their users. Also, in a number of cases the language used in the notes to the financial statements was imprecise or not consistent with the

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<sup>61</sup> IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, paragraph 34.

terminology prescribed by IFRS.<sup>62</sup> Finally, for a few companies, the notes to the financial statements included some mention regarding the audit report of the company itself or that of one of its affiliates. This practice creates confusion by mixing the company's financials and information on the audit procedures conducted on those statements; it is contrary to the requirements of accounting standards.

The above departures, which were identified through the review of randomly selected financial statements of corporate entities in Peru, tend to indicate that compliance with IAS is still insufficient. The areas for improvement discussed above would help increase investors' ability to make investment or valuation decisions that are properly informed by the financial statements. Ultimately, they would contribute to foster foreign investment and lending to the corporate sector.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

40. **Auditing standards as mandated in Peru correspond to a version of ISA that is not up to date and leaves out some significant recent improvements to the international standards, which are important for an adequate level of accountability of external auditors.** As previously indicated, Peruvian GAAS as they stand at the moment, and as included in the latest issue of the Spanish-translated IFAC Handbook, correspond to the version of ISA released by IFAC in 1998. Since then, the International Auditing and Assurance Standards Board (IAASB, a Board within IFAC) has promulgated several ISA statements<sup>63</sup> which have therefore no equivalent in Peru. There is insufficient information available to assess the impact on audit practice of not having implemented or amended these standards. Nonetheless, the fact that such critical matters are not covered by the standards applicable at present, or that the standards have not been updated to reflect certain improvements agreed to on an international level, may contribute to reduce the quality of the audit practice in Peru.

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<sup>62</sup> For instance, "provision" has been found to be used either to describe certain types of liabilities, or write-downs applied to assets.

<sup>63</sup> ISA 260, *Communication of Audit Matters with Those Charged with Governance*; ISA 315, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*; ISA 330, *The Auditor's Procedures in Response to Assessed Risks*; and ISA 505, *External Confirmations*. Also, amendments have been made since then to ISA 200, *Objective and General Principles Governing an Audit of Financial Statements* and ISA 500, *Audit Evidence*.

41. **Compliance with auditing standards especially by small and medium practices is hampered by weaknesses in the oversight of the profession.** Although the comments received by the ROSC team during interviews with CCPL-FCCPP and with the leading audit firms in Peru did not point to serious departures in practice from the standards, those interviewed confirmed the need to introduce quality control mechanisms<sup>64</sup> at the level of the whole profession so as to ensure adherence to ISA and the code of ethics. Another factor that would contribute to improving the quality of the audit practice would be the development of the role of audit committees within Peruvian companies. Indeed, the use of audit committees and other good corporate governance practices have helped enhance companies' internal controls over the financial reporting process, and strengthened the role of external auditors, thus improving the quality and reliability of the financial information communicated to stakeholders.<sup>65</sup>

42. **The ROSC review of published financial statements, although it does not purport to assess audit practices, raises certain issues of compliance with ISA.** Regarding the wording of the audit reports, it was found that auditors in Peru still systematically refer only to Peruvian GAAS (or sometimes just GAAS), although ISA are supposed to be applied. As in the case of accounting standards, the reference to national standards as opposed to international ones reduces the perceived value of the information contained therein by its users, especially for investors with exposure to international markets. In one case, the text of the audit report contained numerous changes to the standard wording provided in ISA (NIA) 700, *The Auditor's Report on Financial Statements*. Finally, none of the exceptions discussed in paragraph 39 above gave rise to any mention in the respective audit reports—except for the audit report's qualification on the aforementioned income tax issue.

## V. PERCEPTIONS OF THE QUALITY OF FINANCIAL REPORTING

43. **Overall, users of financial statements in Peru appear to be relatively satisfied with the quality of the financial reporting by listed companies, but many expressed disagreement with the recent lowering of financial reporting requirements for large, non-listed companies.**<sup>66</sup> Interviews with representatives of banks, investors and other stakeholders revealed a consensus that the financial information on the higher end of the corporate community broadly meets their needs; a view they attribute mainly to the quality of the accounting standards used and to the characteristics of transactions in Peru's private sector, which seldom entail complex accounting treatments. Nonetheless, these financial statement users expressed some concern on the following issues:

- a) the fact that large, non-listed companies are no longer required to have their financial statements audited; these companies could see an incentive to making their financial information available in the fact that this would make their access to long-term financing easier, especially in the form of private equity;
- b) the lack of consistency of the audit practice at the national level, due the absence of a national registry and the lack of self-regulation by the accounting profession;
- c) CONASEV's scarce resources for enforcing financial reporting requirements;

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<sup>64</sup> Including to ensure compliance by the audit firms and individual auditors with ISA 220, *Quality Control for Audit Work* which deals with the procedures the audit engagement teams should apply prior to issuing audit reports.

<sup>65</sup> The Technical Committee of the International Organization of Securities Commissions (IOSCO) has issued a statement dealing with audit committees in October 2002, which could serve as reference for Peruvian authorities.

<sup>66</sup> This information was obtained through interviews conducted by the ROSC team conducting the review of accounting and auditing practices in Peru; interviews involved representatives of banks, institutional investors and capital market participants, as well as a variety of other Country stakeholders.

- d) the existence of different accounting rules in the banking sector; and
- e) to a lesser extent, the relatively slow pace at which the translation of IFRS into Spanish is done.

Furthermore, most users interviewed expressed the view that the financial statements and related publicly available information were not sufficient *per se* to allow investors to make proper investment decisions.

44. **Most users interviewed pointed to the difficulty to access financial statements of non-listed companies, and to their poor quality in general.** Investors and bankers view the elimination of the requirement for non-listed companies to report annually on their financial position and performance as a negative change, hampering their ability to carry out financial analyses. This concern is seen by some as one of the reasons for the commercial banks' unwillingness to lend to the local enterprise sector.<sup>67</sup>

## VI. FINDINGS AND RECOMMENDATIONS

### A. Findings

45. The last decade has witnessed Peru's sustained efforts to improve the quality of its accounting and auditing practices, mainly through the adoption of the respective international standards. Nonetheless, certain weaknesses in the regulatory regime prevent the practice from being fully aligned with these standards. The principal findings of this ROSC are as follows:

- (i) Over the last ten years, the public sector has been very active in improving accounting standards in the private sector. Presiding over Peru's official accounting standard-setting body, the CNC, the Accountant General's Office (CPN) has played a major role in the adoption of accounting standards of high quality. The CPN has also made substantial contributions to their dissemination among the corporations and the accounting profession by publishing guidance material on how to use the standards and organizing courses and seminars on the topic. The two regulatory agencies overseeing capital markets and the financial sector, respectively CONASEV and the SBS, also have important responsibilities with regards to setting and enforcing financial reporting standards and monitoring the audit process.
- (ii) By gradually adopting IAS since 1994 and officially endorsing ISA in 1998, Peru has equipped itself with internationally recognized accounting and auditing standards; a significant improvement in the quality of the financial information among large companies ensued. This process has continued with the adoption of some of the international standards recently. Yet, the standards introduced in Peru have not been regularly updated, nor have the new IFRS or ISA been adopted. The main reason for that is CNC's and the *colegios*' lack of resources. Such delays adversely impact the quality of accounting and auditing standards, as these do not reflect the improvements brought by international standard-setters to make them more apt to provide accurate and reliable information for the financial statement users.
- (iii) The adoption of international standards has not brought similar achievements for SMEs, mostly due to: the complexity of the standards; a lack of adequate capacity among

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<sup>67</sup> Although such causal link has not yet been demonstrated by economic research. Outstanding lending by the banking system has consistently diminished over the last five years, from 50 to 42 billion Nuevo Soles between January 1999 and January 2004 (source Central Banks and SBS).

accountants within small and medium practices; and an absence of enforcement by regulatory agencies. This is also due to the fact that no specific or adapted standards have been developed for SMEs and the absence of regulatory enforcement mechanisms for SME financial statements. Accordingly, users of financial statements perceive that the financial information provided by SME has limited reliability. This is often detrimental to enterprises' access to financing.

- (iv) CONASEV and SBS enjoy accounting standard-setting privileges in their specific areas of purview. SBS has used that prerogative extensively, setting a number of detailed accounting rules for banks, insurance companies, etc. These rules are to be applied for both regulatory and general-purpose financial reporting. Most reflect international practice in disclosure on specific aspects of the banking or insurance sectors. Nonetheless, a number of these sector-specific accounting rules applied for the preparation of general-purpose financial statements are inconsistent with IFRS. CONASEV has passed one regulation dealing with accounting that was meant to facilitate the transition to international standards by allowing that the recognition of deferred income tax liabilities be spread over 13 years; but that regulation contradicts IFRS which require such liabilities to be recognized immediately.
- (v) As a result of CONASEV's efforts, public access to listed companies' financial statements and related corporate information is easy and timely. This contributes to the financial transparency of the securities market and therefore to investors' confidence.
- (vi) Until recently, CONASEV's mandate included a large number of non-listed companies. However, this mandate was restricted to listed companies through an amendment of the Law on CONASEV in 2000. This has significantly reduced the availability to investors and banks of financial information on non-listed enterprises.
- (vii) Membership in one of the professional accounting associations, or *colegios*, is compulsory for all accountants in public practice, including auditors. The *colegios* enjoy significant privileges under the law, including: awarding and repealing accountant and auditor licenses; setting auditing standards; and issuing and enforcing accounts' code of professional conduct.
- (viii) The license to conduct audits is awarded by the profession's representative bodies, the *colegios*, who require a university degree, a five-year *colegio* membership and having attended courses on auditing. Would-be auditors do not need to take any professional examination however. Moreover, once accountants are qualified, there is no continuing education or quality control requirement for them to retain their licenses.
- (ix) The code of ethics developed by the *colegios* sets the fundamental principles of professional conduct for accountants but lacks precision on incompatibilities and guidance on how the code should be applied to particular circumstances.
- (x) Most universities provide academic curricula in accounting and auditing; but there is no minimum course content set nationwide, nor is there currently a consensus among the country's universities as to the courses that should be included in these curricula. Consequently, the quality of accounting education is inconsistent. Moreover, dissemination of the standards and continuing professional education in accounting is lacking, which negatively affects compliance.

- (xi) Enforcement of accounting and auditing standards by the regulatory agencies is hampered by a lack of resources, especially in the case of CONASEV (whose funding is provided in part by supervised entities through contributions), and by the fact that both CONASEV and SBS lost their powers to award and repeal the license of statutory auditor.
- (xii) The *colegios* do not enforce auditing standards or the code of ethics, although they are required to do so under the law; thus, sanctions against practitioners are very rarely imposed.
- (xiii) As in most Latin American countries, audit committees are not mandated by law and are in fact uncommon among Peruvian companies. This situation corresponds to the early stage of development of governance mechanisms in the private sector, reflecting a corporate structure largely influenced by strong family ownership as is typical across the continent. Regarding listed companies, CONASEV's voluntary code of good practices of corporate governance recommends that special committees of the Board be established, including on audit. In the banking and insurance sectors, SBS-issued norms on internal audit and internal control systems requires companies to set-up audit committees.
- (xiv) The legislation applicable to accounting and auditing in the private sector is relatively recent and appears to provide an adequate basis for strengthening financial reporting practices in the near future, although certain of the recommendations of this ROSC require amending the law.

## **B. Policy Recommendations**

46. The policy recommendations arising from the ROSC assessment of current accounting and auditing practices in Peru will be presented to the country stakeholders on occasion of a workshop in Lima, as part of the finalization of the report. Inputs from the stakeholders will be incorporated into a Country Action Plan to be developed under the supervision of the Ministry of Economy and Finance (MEF), with the assistance of the World Bank and possibly other international development partners. These recommendations would benefit a wide range of Peruvian stakeholders, including:

- The securities market (BVL), whose capacity to attract foreign investment would be enhanced by further compliance with international standards; also, enhancing the availability of financial information and the effectiveness of audits leads to greater transparency in the market and offers more investment opportunities to local and foreign investors;
- Peru's financial sector in general, since facilitating their public availability of statutory financial statements can allow investors and banks to carry-out comparative analysis of financial data within the same sector; combined with increased quality and reliability of the financial information, this can foster investing and lending activities in the country;
- Increasing investors' access to financial statements and their confidence in the reliability of those statements will ultimately increase the availability of capital and help reduce the cost of financing for Peruvian enterprises—especially SMEs and large non-listed enterprises;
- Employees of the private sector, who have an important stake in their company's success, and are therefore entitled to receive complete and accurate financial information. The reliability of financial statements is also directly relevant to workers

since the law grants them a share of corporate profits. In addition, more transparent financial information would help private pension funds make investment decisions and monitor the performance of their investments, which in turn would benefit future retirees;

- The public sector, since taxes on corporate profits are based on accounting records; reinforcing accounting and auditing practices in the corporate sector would support the government's efforts to limit tax evasion. Moreover, strengthening the financial reporting regime of the private sector will be beneficial to Peru in the perspective of future concessions or privatizations.

47. **CNC should be allocated a specific recurrent budget by the Government in order to be able to carry-out its standard-setting responsibilities in a timely fashion.** Those responsibilities are mainly the translation of IFRS—including related IASB guidance and IFRIC interpretations. CNC's involvement should also include the translation of IASB's exposure drafts that are circulated to national standard-setters for comments before the standards are finalized and made official at the international level. Increasing its resources would allow CNC to prepare the translations and involve stakeholders at an early stage of the process, and if necessary to prepare specific guidance to facilitate their use. This would allow issuers and auditors to refer to IFRS, thereby enhancing investors' confidence in applicable standards and thus in the financial statements. Furthermore, considering its scarce resources, CNC should seek cooperation with other Spanish-speaking standard-setters, so as to obtain economies of scale in the standard-setting process and at the same time maximize comparability of standards among Latin American countries and avoiding the use of different IFRS translations.

48. **CNC should as a matter of priority establish simplified accounting and financial reporting standards that could be used by SMEs on a voluntary basis.** Considering that SMEs have a much more limited range of stakeholders than public interest entities,<sup>68</sup> they should be subject to SMEs accounting and financial reporting obligations commensurate with their smaller size, narrower range of activities and simpler transactions. In this context, the IASB has initiated a project to issue a set of standards dealing specifically with financial reporting by SMEs. By providing SMEs with a more adequate framework for financial reporting, CNC would help them improve the quality of their financial information, which would make access to credit easier and cheaper for them, and in turn would enhance their competitiveness and boost their development.

49. **Peru's largest non-listed companies should be required by law to present annual audited IFRS-based financial statements, and these statements should be made available to the public.** The criteria for determining which entities would be subject of that obligation should include: the amount of revenues, total assets and number of employees. Considering that capital market are still at an early stage of development in Peru, financial transparency in the corporate sector would receive a significant boost if the financial statements of the largest non-listed enterprises were available to investors, banks and the public in general.<sup>69</sup>

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<sup>68</sup> Public interest entities include listed companies, banks, insurance companies, pension fund administrators, capital market participants, large SOEs and any other large enterprise that, according to its size (which may be measured by the amount of revenues it generates or assets it owns, or by its number of employees), or types of activities. In the case of Peru, discussions with country stakeholders indicated that the total number of such public interest entities could be in the region of 1,000. As previously mentioned, under Peruvian law, entities of the banking, insurance and pension sectors are required to be listed on the stock market.

<sup>69</sup> A bill has been presented in June 2003 before the Peruvian Congress for the extension of CONASEV's supervision to all companies with annual revenues in excess of 831 UIT. This bill is still under discussion at present. Nevertheless, as suggested above, a more appropriate approach would be to

50. **In order to allow CONASEV to strengthen its enforcement capacities, the authorities should allocate more resources to the market regulator.** This would lead to increased compliance by companies with IFRS and other financial reporting requirements, and thus to a higher quality of information. CONASEV should have a department specifically dedicated to proactively monitor financial reporting by entities under its supervision and an adequate staff.

51. **The SBS in cooperation with CNC should seek to harmonize accounting principles for banks' or insurance companies' for general-purpose financial reporting with IFRS.** The fundamental objectives of financial statements, whether they are issued for general or regulatory purposes should be broadly the same, i.e. providing a true and fair view of the reporting entity's financial position. These objectives are best served when sound accounting principles are applied in the preparation of the financial statements; IFRS is widely acknowledged to provide such sound principles, which is why Peruvian authorities have officially recognized them. Conversely, any special rule designed for prudential and/or regulatory purposes could be adverse to fulfilling the financial statements' true and fair view objective. Accordingly, banks, insurance companies and other SBS-regulated entities should follow IFRS in preparing their statutory, general-purpose financial statements. The SBS could require any additional financial information it may need for its regulatory purposes, or a separate set of regulatory financial statements as banking and insurance regulators do in other countries such as France or the U.S.<sup>70</sup> This would add clarity to the financial statements of financial sector entities in the view of investors, and to diffuse any concern they may have on the reliability of those statements. Such adoption implies a period of transition during which institutions in the banking, insurance and pension systems, as well as their auditors and other stakeholders, will be able to anticipate the impacts of such adoption and adequately prepare it. One of the issues that would need to be analyzed during the transition period is the fair value of financial instruments with low liquidity.<sup>71</sup>

52. **The *colegios*' and FCCPP's code of ethics should be amended to clarify incompatibilities and provide guidance to practitioners.** This will help mitigate the risk of misinterpretations on situations of potential conflicts of interest. In amending its code of ethics, the FCCPP should closely monitor the reforms currently being introduced in IFAC's Code of Ethics for Professional Accountants, so as to ensure maximum consistency and indirectly benefit from the inputs provided by IFAC members on how accountants' ethics code should be improved. Additionally, the FCCPP should involve the authorities in this process so as to obtain their formal endorsement of its amended ethics code for statutory audit purposes.

53. **Peruvian authorities should establish an independent Auditor Oversight Board.** The primary role of the Auditor Oversight Board will be to ensure that statutory auditors have strong academic background and professional skills, and that they comply effectively with both ISA and applicable ethical requirements. The Oversight Board would follow the model of the CNC, which has proven successful in the field of accounting standard-setting, involving all Government

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consider multiple criteria for subjecting companies to increased public reporting requirements. In addition, further analysis should be conducted to determine which amounts are adequate to include only entities that have the desired public interest characteristics (the proposed revenue threshold of 831 UIT is equivalent to less than US\$ 1 million).

<sup>70</sup> In addition, if necessary and in a limited number of instances, the text of the standard could be adapted to eliminate some of the options offered by IFRS.

<sup>71</sup> Under IAS 39, investment securities classified as trading or available-for-sale must be carried at fair value. In the case of investment securities that are not traded or that have low liquidity, the fair value must be assessed using valuation techniques based on estimated future cash flows, which depend on estimates and assumptions that can introduce some volatility and raise issues of possible lack of consistency and homogeneity. In such cases, a solution would for SBS to establish a methodology applicable by preparers of the financial information.



agencies entrusted with regulating the public accounting profession and the audit practice, i.e. the CPN, CONASEV, the SBS and the Auditor General of the Republic. The accounting profession would be closely involved in the work conducted by the Auditor Oversight Board. Nevertheless, a majority of its members would have to be non-practitioners, representing public authorities, academia, financial statement users and the civil society; nomination would have to follow a due process to be provided in the Law. This change would reflect the trend recently observed on an international level toward a more robust regulation of the audit practice, and would help bring better international recognition for Peru's financial reporting regime. Ultimately, this will lead to improving practitioners' accountability vis-à-vis the users of corporate financial statements. The Oversight Board would have the following functions:

- Awarding, renewing and repealing licenses for statutory auditors among listed companies and other public-interest entities. In that regard, a due process of certification similar to the one in place in Mexico<sup>72</sup> would be the best solution for qualifying auditors. The Oversight Board may delegate part of the function to award the certification (e.g., examination, continuing examination) to a professional or private organization through a formal agreement and under strict conditions provided in the Board's By-laws; from the profession's standpoint, there would be an incentive in seeing such system of certification being developed in Peru, as it would align the country with the standards of professional accreditation that are observed in industrialized nations and in some emerging economies—including Mexico and Brazil;
- Approving and/or adopting of ethical standards and requirements for internal quality controls within audit firms;
- Ensuring statutory auditors get adequate continuing education;
- Ensuring statutory auditors' compliance with auditing standards and independence and quality control requirements; to that effect, it would have to conduct investigations and exercise disciplinary powers as necessary; and
- Reporting on its annual work programs and the results of its activities, including any sanctions taken against statutory auditors.

54. **The arrangement under which the Auditor Oversight Board (AOB) would conduct its mission will be further defined in the Country Action Plan.** In any event, an adequate funding mechanism for the AOB will need to be set-up; and such mechanism will have to preserve the AOB's independence. Over the last three years, several countries have introduced oversight mechanisms, following different approaches such as establishing an ad-hoc government supervisory agency, like the U.S. PCOAB, or creating a system of oversight in which the accounting profession takes a significant part. Also, in some countries (e.g., the UK, with the Financial Reporting Council), the AOB is part of a broader entity that covers other functions such as (i) issuing accounting principles, (ii) issuing auditing standards, and (iii) monitoring reporting entities' compliance with applicable accounting principles. In the case of Peru, the rationale for having an Oversight Board as a separate entity from the accounting standard-setter (CNC) and not to include enforcement of financial reporting requirements in its mandate would be that:

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<sup>72</sup> Mexico's Institute of Public Accountants introduced accountant certification in 2001. Certification entails a professional examination, a minimum experience requirement and a minimum 65 hours of yearly continuing education. Mexican authorities have officially endorsed such certification by making it a requirement for auditing listed companies or banks. As part of the NAFTA agreement, Mexican certified public accountants who have passed additional examinations on country legislation and regulation can practice accountancy in Canada and the U.S.

- Regarding the CNC, its exclusive mandate is to set accounting standards and its membership does not include the Auditor General; while the Oversight Board would ensure the quality of the audit practice in both the public and the private sectors, which would require the involvement and cooperation of the Auditor General as this institution is constitutionally empowered with overseeing Peru’s public financial system;
- Regarding enforcement of financial reporting and related obligations in the financial system (securities market, banking sector, etc.), entrusting the AOB with that responsibility would probably require changing the constitution, especially regarding the SBS’ powers.

55. **The authorities should seek, in cooperation with the universities, to harmonize and strengthen academic curricula in the field of accounting and auditing.** This would allow future practitioners to have sufficient knowledge and competence to undertake the responsibilities of *contador público*. Such cooperation should involve the Assembly of University Rectors and deans of business administration and/or accounting faculties. Strengthening accounting curricula would represent an important step for a wider array of universities to gain a proper recognition from the business community.

56. Technical Assistance will be needed to put the above recommendations into practice on various aspects including: drafting new legislation or amendment to existing acts and/or regulations; establishing the Auditor Oversight Board; updating procedures for regulators to enforce financial reporting requirements; and addressing related recruitment and training aspects. The Country Action Plan will deal with the scope, cost and funding of such Technical Assistance and training, as well as the issue of specifying the resources to be allocated to the Audit Oversight Board and to CONASEV. As regards the support provided by the World Bank, the ROSC team will assist the authorities in seeking international funding from mechanisms specific intended to support the types of reforms contemplated in this report—e.g., the Financial Sector Reform and Strengthening Initiative (FIRST), the Multilateral Investment Fund (MIF), Consulting Trust Funds, etc.

### C. Institutional Capacity and Training

57. **Strengthening the enforcement of applicable accounting and financial reporting standards.** The quality of corporate financial reporting depends not only on established accounting standards but on the effective enforcement of those standards. As noted by the ROSC review, and as confirmed by certain financial statements users, there is a compliance gap with regards to accounting principles in Peru. Consequently, monitoring compliance with accounting standards should be strengthened, especially on the part of CONASEV who should have sufficient resources to conduct in-depth reviews of statutory financial statements and on-site inspections of companies and auditors—including an adequate number of staff, sufficient funding to allow proper staff compensation, etc. Technical Assistance will be needed to precisely assess those needs and possibly adjust the structure and organization of CONASEV. Additionally, the staff of the regulatory agencies needs to receive training from time to time, so that they would be in a position to effectively enforce compliance with IFRS. Specifically, in the banking sector, the SBS should use as a reference in discharging its supervision functions, the Basel Committee paper on *The Relationship Between Banking Supervisors and Banks’ External Auditors* (see paragraph 32).

58. **Establishing the Audit Oversight Board and setting-up a process of professional certification for awarding the license of statutory auditor.** The first step should be to define the by-laws and regulations under which the Board will operate, including: (i) setting-out auditor licensing and quality control requirements; (ii) designing annual work programs to conduct inspections of statutory auditors and audit firms; and (iii) procedures for the communication and resolution of findings arising from the inspections and sanctions mechanisms. Technical Assistance will be needed to precisely design those processes as well as for the corresponding recruitment, preparation and training efforts for the Oversight Board's permanent staff. The content, cost and funding of this technical Assistance, as well as the Oversight Board's recurring budget, will be provided in the Country Action Plan. Regarding the implementation of a process of professional certification for statutory auditors, cooperation should be sought with other Latin American countries which have already established such mechanisms (e.g., Mexico) or are currently considering doing so.

