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REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Paraguay

ACCOUNTING AND AUDITING

June 1, 2006

CONTENTS

This report was prepared by the World Bank on the basis of a diagnostic review carried out in Asunción between October 2005 and March 2006, with the participation of the Inter-American Development Bank (IDB). The task team was led by Henri Fortin (LCSFM) and also included Orlando Ferreira (LCSFM), Joanne Givens (LCSFM), and Norberto Diamanti (IDB). Jamil Sopher provided assistance with regards to quality review. The task team also received the support of the World Bank Country Management Unit (LCC7C) in Asunción, Buenos Aires and Washington. The review was conducted through a participatory process involving various stakeholders and led by the Government of Paraguay. This assessment was cleared for publication by the Ministry of Finance on December 28, 2006.

CURRENCY: PARAGUAYAN GUARANI (PYG)

1 US$ = 5,870 PYG as of May 15, 2006

ABBREVIATIONS AND ACRONYMS

AFD	Public Financial Development Agency
AIC	Interamerican Accounting Association
BCP	Central Bank of Paraguay
BNF	National Development Bank
BVPASA	Asunción Stock and Commodities Exchange
CAC	Credit Cooperative
CAP	Country Action Plan
CGR	Auditor General of the Republic
CNV	National Securities Commission
DGGC	Large Taxpayers Office
DPL	Development Policy Lending
FDI	Foreign Direct Investment
FIN	Financial Companies - *Financieras*
FSAP	Financial Sector Assessment Program
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GDP	Gross Domestic product
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IDB	Inter-American Development Bank
IES	International Education Standards for Professional Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
INCOOP	National Institute of Cooperatives
IMCP	Mexican Institute of Public Accountants
ISA	International Standards on Auditing
MoF	Ministry of Finance
MERCOSUR	Southern Cone Common Market
MIF	Multilateral Investment Fund
NSC	National Steering Committee
ROSC	Report on the Observance of Standards and Codes
SIB	Superintendence of Banks
SIS	Superintendence of Insurance
SME	Small and Medium Enterprise
SOE	State-Owned Enterprise
SSET	Tax Administration

EXECUTIVE SUMMARY

1. This report provides an assessment of Paraguay's corporate accounting and auditing practices, using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks, and drawing on international experience and good practices in those fields. The main purpose of this ROSC is to assist the Government of Paraguay and stakeholders in strengthening and improving the financial reporting regime in the country. The development objectives these efforts support are: (a) improving the business environment in Paraguay and making it more attractive for domestic and foreign direct investment, (b) enhancing financial transparency in the corporate sector; and (c) enhancing opportunities for greater economic integration with the region and the world.

2. **In 1989, Paraguay began a slow and difficult road toward democracy after emerging from 35 years of authoritarian rule**. The former regime left a complex legacy of weakened institutions, a dwindling stock of human capital and a severe lack of transparency in many of the country's public and private sector institutions. Economic performance during these last 16 years has been weak, showing negative real growth in any five year period since 1994.

3. **The country's economic activity still relies heavily on agriculture, hydroelectric generation and informal trade, mainly with Argentina and Brazil**. The agriculture sector generates 90 percent of exports and provides a third of the jobs at the cost of great volatility due to variations in international prices of commodities and climatic conditions. Poverty and inequality remain defining characteristics of Paraguay's economic and social landscape. According to a 2004 survey, 39.2 percent of the population lived below the national poverty line.

4. **To achieve the goal of equitable and sustainable development, Paraguay's private sector must assume a leadership role**. Achieving this goal will be a difficult challenge. According to the 2006 World Bank Doing Business Indicators, Paraguay ranked below 120 out of 155 countries surveyed for indicators measuring time required to start a business and rigidity of employment. The 2005 Global Competitiveness Index published by the World Economic Forum ranked Paraguay 102 out of 117 countries and 20 out of 21 in Latin America and the Caribbean. This scenario is further exacerbated by the perception both inside and outside the country of pervasive corruption and lack of rules. International surveys and research conducted at multilateral institutions have highlighted this issue. A recent example is the Country Policy and Institutional Assessment carried out in 2005 by the World Bank.

5. **Another major impediment for private sector-led growth in Paraguay is the limited availability of financial resources for investment**. Net inflows from foreign direct investment averaged 2 percent of GDP from 2003 to 2005, which is a marked improvement from previous years, but remains below regional levels. As in most of Latin America, savings are mostly short-term. During the last 10 years, average maturities of deposits have not exceeded 18 months in Paraguay, which limits the capacity of financial institutions to lend for purposes beyond working capital. Adding to this, the environment has not been conducive to lending and banks have limited their operations, concentrating on large corporate clients in the export sector. By December 2005, financial institutions showed very low ratios of loans to deposits (close to 58 percent), and placed 45 percent of their resources in Central Bank issued papers.

6. **A new government took office in August of 2003, elected on a platform of fighting corruption and reforming the state**. So far, the administration of President Nicanor Duarte Frutos has been able to deliver on the reform of tax and customs legislation and has kept government spending under control. Economic conditions have improved in the last three years

with real GDP growth averaging 1.1 percent. The foreign currency component of bank deposits dropped from 70 percent in 2001 to 55 percent in 2005, indicating renewed confidence in the local currency; the stock market, although still small, has tripled its volume of operations; and interest rates both in foreign and local currency continue their downward trend.

7. **Developing a high-quality corporate financial reporting regime can help harness Paraguay's potential, improve access to financial resources, and boost the country's competitiveness and global integration**. Additionally, the existence of clear rules that are complied with and enforced, coupled with adequate availability and disclosure of high-quality financial information can help dispel the negative perception about lack of transparency in the country's business community. This report will focus on Paraguay's challenging road ahead toward achieving these goals.

Paraguay's statutory framework for accounting and auditing

8. **The principal finding of this ROSC is that Paraguay has an incomplete, fragmented and loosely enforced statutory framework for accounting and auditing**. Outside the financial, cooperative and, to a lesser extent, state-owned sectors, (referred to as supervised sectors) there are no legally sanctioned standards and no enforcement mechanisms. Only one fourth of the largest 200 companies in the country belong to one of these sectors.

9. **Recently enacted tax law empowers the Ministry of Finance (MoF) to adopt standards for accounting and auditing**. The Ministry may impose International Financial Reporting Standards (IFRS) or other Generally Accepted Accounting Principles (GAAP) on Paraguayan taxpayers, provided they would not conflict with tax regulations. The law also mandates external audits for companies with revenues above one million US dollars, however, to put this into practice, the tax administration is required to establish a registry for external auditors and set auditing standards. As of the date of this report, none of these provisions had been implemented.

10. **Within the supervised sectors, the quality of standard setting, compliance with standards and supervision of compliance is uneven and the regulation in place is fragmented**. The Banking Superintendency (SIB) appears as the strongest regulator. As in many other countries, banking regulation has a prudential focus and differs significantly from IFRS. The National Securities Commission's accounting standards although based on international standards, date back to 1992 and have not been updated. The insurance and cooperative sectors are facing new sets of accounting rules that become effective in 2006. It is too early for a full assessment, but it is clear that in both cases the new statutes are significant improvements over existing ones. State-owned enterprises are subject to the supervision of the Auditor General of the Republic (CGR); but CGR's role is mostly focused on oversight of procurement processes and investigation of fraud allegations.

11. **All five regulatory agencies maintain a separate registry for external auditors, causing duplication of efforts**. Each agency has its own set of rules, which range from highly detailed, such as those issued by SIB or the Superintendency of Insurance (SIS), to broad guidelines, as is the case with the National Institute of Cooperatives (INCOOP). These different registries, coupled with the possibility of a sixth registry likely to be created by the tax administration, impose an unreasonable burden on audit firms. A cross-check of membership in each respective registry shows that 26 out of 34 companies belong to at least three. External auditors must periodically renew these memberships, through processes that are mostly redundant. More importantly, there is no formal process of communication between registries, so

it is possible for an auditor suspended in one registry to be present in another. These registries are intended to regulate professional practice, provide a basis for quality control, and set minimum professional standards, including a requirement for previous experience and adequate institutional capacity for audit firms and individual practices; none of these regulations requires professional examination or continuing education however.

Improving the quality of professional practice

12. **University curricula in accounting and auditing in the country are not subject to any type of minimum requirements, and efforts should be made towards harmonization with the International Federation of Accountant's (IFAC) educational standards**. Establishing educational standards is in line with international benchmarks is all the more important since, with the exception of supervised sectors, a college degree in accounting is the main and often the only requisite for a professional accounting or auditing practice. The team interviewed five universities that offer accounting degrees and found great interest in the improvement of accounting education but, as is often the case; the lack of resources – technical and financial – is a major impediment.

13. **The accounting profession in Paraguay is organized through voluntary associations.** The Paraguayan College of Accountants, (*Colegio*) was established in 1916 and has close to 2,100 members. Its Professional Board adopted IFRS and ISA in 2003 but, without legal backing, the *Colegio's* resolutions are viewed only as guidelines by practicing accountants and auditors. The *Colegio* organizes annual conferences and offers regular courses and seminars on professional issues. In March of 2005, over 200 professionals formed a new organization, the Paraguayan Council of Public Accountants, (*Consejo*). The *Consejo* has recently published a Code of Professional Ethics and a volume of Auditing Standards.

14. **Efforts made by the profession to set, disseminate, and enforce the use of accounting and auditing standards and a code of ethics by their members have met limited success**. The professional associations do not have enough resources and although highly qualified professionals have volunteered valuable time to achieve these goals, such an approach lacks sustainability. International standards for accounting and auditing are constantly evolving. Adoption of these standards requires continued monitoring and evaluation before they can be implemented in any country. The task of setting standards is a full time occupation, and the same can be said for the tasks of enforcing standards and effectively imposing a code of ethics for professional practice. Even with significant strengthening and increased resources, it is difficult to envision the professional associations in Paraguay assuming all of these roles. This report endorses the alternative of a specialized institution with ample participation of the profession and other relevant sectors.

15. **Implementing a high-quality financial reporting regime will require significant efforts in the areas of professional education and capacity building**. Three main sectors should be targeted for action: (i) in the academic sector, university curricula for accounting and auditing must be updated and harmonized with IFAC's education standards. Professors must be trained to effectively deliver better quality courses; (ii) in the regulatory sector, supervisors charged with enforcing new regulation will require training; and (iii) practicing accountants and auditors must significantly improve and expand current efforts directed at continuing professional education.

Transparency in financial reporting

16. **Paraguay's statutory framework does not require the publication of audited financial statements by any public-interest entity, except listed companies.** Publication requirements exist only for some supervised companies, and they differ significantly from one sector to another. CNV makes the financial statements of listed companies readily available on its website. Banks, insurance companies and large cooperatives are required to publish abbreviated financial statements in a newspaper. SOEs are not required to publish their financial statements, although some do so voluntarily. There are no publication requirements for non-listed companies.

17. **The perception of corruption and lack of rules is one of the major obstacles that Paraguay's corporate sector must overcome to attract domestic and foreign investment.** The arguments against publication of financial statements center on the costs involved and the revelation of strategic information to existing or potential competitors. These arguments, although valid, do not take into consideration that enhancing investor and creditor protection is vital to improving the country's business climate, which in turn benefits all. Also, from the point of view of the entrepreneur, availability of good information will help to improve strategic planning and execution of complex business scenarios. Recent developments in the country's stock market show that when given a real choice based on adequate information and the confidence that follows transparency, investors are willing to channel financial resources into the country's companies. Paraguay's private sector must assume leadership for compliance and disclosure.

The road ahead

18. **The description of Paraguay's statutory framework for accounting and auditing points directly to the need for clear and comprehensive rules**. Paraguay's accounting and auditing statutory framework should follow a coherent structure. It must have an efficient standard-setting process and a strong, capable institution to monitor the quality of professional practice and enforce the statutes.

19. **Moreover, the report recommends actions toward building capacity within academia, regulatory agencies and the accounting and audit profession.** It also includes recommendations in the areas of professional examination and continuing education.

20. **Companies, especially those that have public-interest characteristics should be made aware of the potential benefits derived from high quality and transparent financial reporting**. Greater awareness is the fastest way to foster disclosure and compliance.

21. **Addressing the weaknesses in the accounting and auditing environment and achieving the needed improvements will require a strong involvement of the Government and the contribution of all key stakeholders.** The main challenges for in-country stakeholders will be to arrive at the necessary consensus in order to develop an effective Country Action Plan (CAP) and secure the commitment of all involved in its implementation.

22. **At the suggestion of the ROSC team, the MoF convened a meeting with representatives of the accounting profession, the five regulatory agencies, the business community, and academia**. This meeting was chaired by Minister Bergen and took place on March 3, 2006, during the main mission of the ROSC Accounting & Auditing in Asunción. The team recognized this as a significant step, and in order to give this group the structure and resources required to become the real force behind the proposed reforms, it is the first recommendation of this report that through an official act of the MoF, a National Steering

Committee (NSC) should be formally established, its terms of reference defined and its members appointed. The membership of the NSC should include the institutions that participated in the aforementioned meeting. The NSC should have a Secretariat equipped with a small staff to be provided by the MoF. All member institutions are expected to contribute significant time to the preparation and monitoring of the CAP. The NSC should also serve to mobilize donor support to carry out the CAP.

23. The ROSC recommendations are summarized in the following table, which presents recommendations in the order in which they appear in the body of report. A second table provides a tentative implementation timeline.

SUMMARY OF RECOMMENDATIONS					
Action	**Reference** (Para.)	**Responsibility**	**Timing of effective implementation**		
			Short-term (within 1 year)	**Medium-term** (1 to 2 years)	**Long-term** (3 to 5 years)
1. Establish the National Steering Committee (NSC) on Accounting and Auditing, in charge of developing and implementing the Country Action Plan (CAP): a. Through an official act of the MoF, formally establish the NSC, set its terms of reference and appoint its members b. Provide adequate resources to the NSC to enable it to carry out its function effectively c. Formulate and implement the CAP	72	MoF (with the support of in-country stakeholders and donors)		**Continuing process** **Continuing process**	
2. Pass a law to (i) making IFRS and ISA the mandatory accounting and auditing standards in Paraguay and (ii) create a professional oversight body for accounting and auditing. SMEs should be subject under that law to a simplified set of standards based on the international SME standards currently under in preparation.	73	MoF			
3. Establish the professional oversight body convening all relevant stakeholders to carry out the following roles:					
a. Setting accounting and auditing standards in the country.	78(a)	MoF (with support of NSC membership)			
b. Awarding and revoke professional licenses for accountants and auditors.	78(b)				
c. Enforcing auditing and ethical standards including the use of sanctions in cases of non-compliance.	78(c)				
4. Harmonize the regulatory framework for accounting and auditing					
a. Develop a certification mechanism for accountants.	79 (a)	NSC (to be transferred later on to Oversight Body)			
b. Develop a unified process for accreditation and certification of external auditors.	79 (b)				
c. Implement publication requirements for all public-interest companies.	79 (c)				

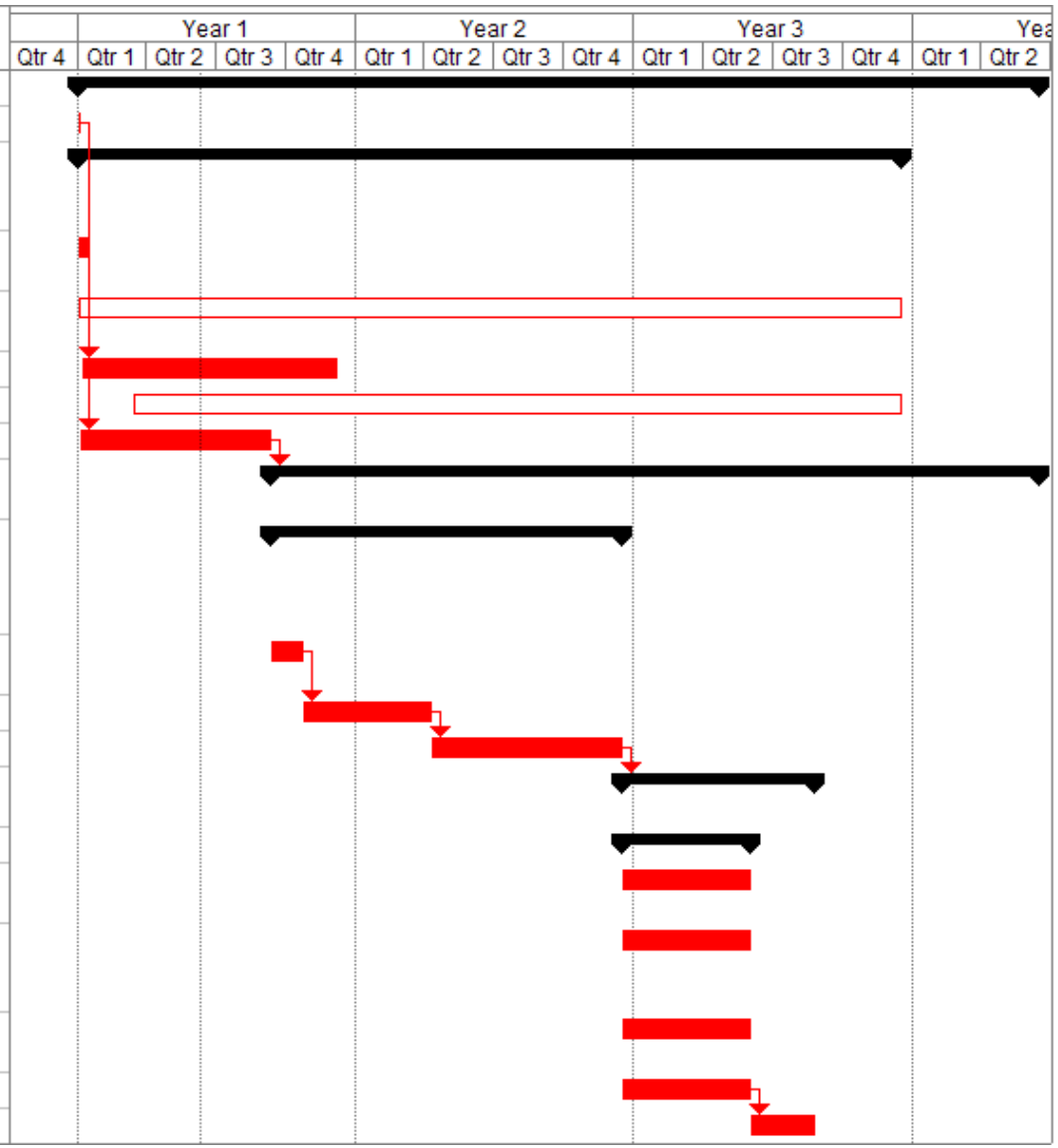
d. Harmonize rotation of external auditors, and extend the current 2- to 3-year term to 5 years.	79 (d)		

SUMMARY OF RECOMMENDATIONS (CONTINUED)

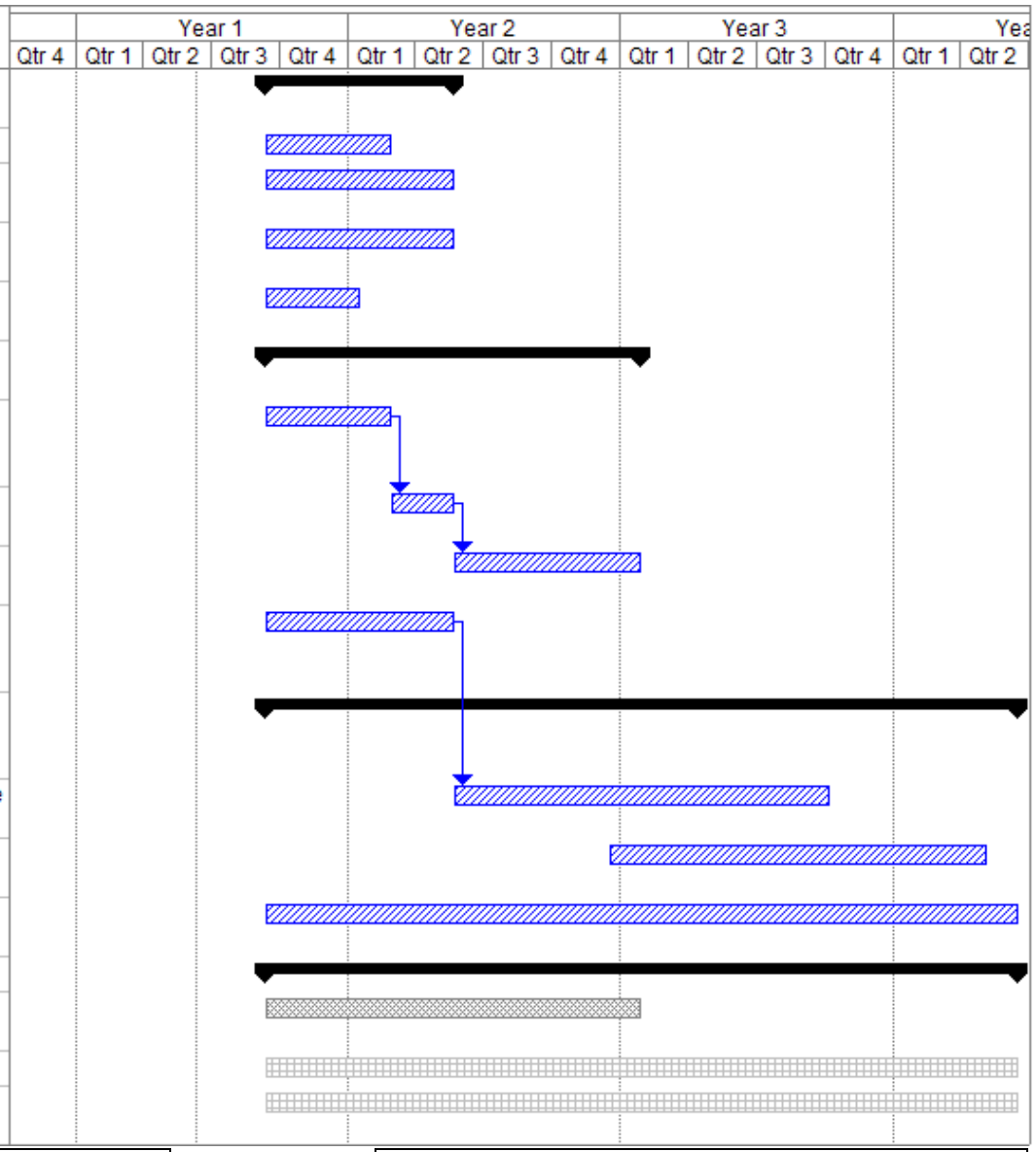
Action	Reference (Para.)	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	**Medium-term** (1 to 2 years)	**Long-term** (3 to 4 years)
5. Require external audits from all SOEs and create a mechanism to monitor SOE financial reporting. These audited financial statements should be made available to the general public.	80	MoF			
6. Update academic curricula in the field of accounting and auditing in line with IFAC's International Education Standards.	81	National Accreditation Agency			
7. Undertake a comprehensive effort to build capacity for an improved financial reporting regime in Paraguay:					
a. Train university professors to effectively implement the reformed curricula.	82 (a)	Universities			
b. Train staff at regulatory agencies to effectively enforce the reformed statutory framework.	82 (b)	SIB, SIS, CNV, INCOOP, CGR			
c. Improve and expand the existing training programs for accountants and auditors.	82 (c)	*Colegio*, *Consejo*			
8. Other long-term actions to be considered:	83				
a. Clarify the function of *síndico,* eliminating any redundancy with the roles of external auditor and audit committee.		MoF			
b. Harmonize regulatory standards with IFRS.		SIB, SIS, CNV, INCOOP			
c. Make financial statements from all public-interest entities available to the general public.		MoF/NSC			

ROSC A&A Paraguay – Tentative Implementation Timeline

ID	Summary of Recommendations - Timeline
1	**ROSC A&A Paraguay - Tentative Implementation Timeline**
2	Publication of Paraguay ROSC A&A
3	**[1] Establish the National Steering Committee on Accounting and Auditing, in charge of developing and implementing the Country Action Plan (CAP).**
4	Through an official act of the MoF, formally establish the NSC, set its terms of reference and appoint its members
5	Provide adequate resources to the NSC to enable it to carry out its function effectively
6	Dissemination of Report
7	Round Table discussions
8	Definition of a Country Action Plan
9	**Implementation of ROSC Recommendations and Country Action Plan subject to discussion with in-country**
10	**[2] Pass a Law making IFRS the mandatory accounting standards in Paraguay and creating a professional oversight body. SMEs should be required to apply IASB's sector specific standards now in**
11	Discussion among stakeholders, consensus building activities
12	Design of the legislative reform
13	Congressional treatment and approval
14	**[3] Establish the professional oversight body convening all relevant stakeholders**
15	**Design the institution's operating structure**
16	Develop a roadmap for the application of IFRS as the mandatory standards in Paraguay
17	Develop a system for awarding professional licenses for accountants and auditors including professional examination
18	Develop the necessary institutional framework to enforce auditing and ethical standards
19	Identify, hire and train staff
20	Start operations



ID	Summary of Recommendations - Timeline
21	**[4] Harmonize regulatory framework for accounting & auditing**
22	Develop a certification mechanisms for accountants
23	Develop a unified process for accreditation and registration of external auditors
24	Implement publication requirements for all public-interest entities
25	Harmonize rotation of auditors and extend the current 2 to 3 year term to 5 years
26	**[5] Improve financial reporting by state-owned enterprises**
27	The government should create a mechanism, possibly under the Ministry of Finance, to monitor financial reporting from SOEs
28	External audits should be mandatory, on an annual basis and financed with the companies' own budget
29	Financial statements from SOEs should be made available to the general public online.
30	**[6] Update academic curricula in the field of accounting and auditing to achieve harmonization with IFAC's education standards**
31	**[7] Undertake a comprehensive effort to build capacity for the implementation of an improved financial reporting regime in Paraguay**
32	Train University professors to effectively implement the reformed curricula
33	Train Staff at regulatory agencies to effectively enforced the reformed statutory framework
34	Improve and expand the existing training programs for accountants and auditors
35	**[8] Other long-term actions to be considered**
36	Clarify the role of sindico and eliminate redundancy with the role of external auditors
37	Harmonize regulatory accounting standards with IFRS
38	Make financial statements from all public-interest entities available to the general public



Color Key	Legend
	High Priority Action
	Medium Priority Action
	Low Priority Action
	Low Priority Action Requires substantial discussion among stakeholders

This tentative timetable is indicative and solely intended as input for the preparation of the Country Action Plan

I. BACKGROUND

1. This review of accounting and auditing practices in Paraguay is a part of the World Bank (WB) and International Monetary Fund (IMF) joint initiative to prepare Reports on the Observance of Standards and Codes (ROSC). The review focuses on the strengths and weaknesses of the accounting and auditing environment in the corporate sector and how they influence the quality of corporate financial reporting. International Financial Reporting Standards (IFRS)[1] and International Standards on Auditing (ISA)[2] were used as benchmarks for this assessment, which included both statutory requirements and actual practices.

2. **Paraguay is a landlocked country of 400,000 km^2 and 6 million inhabitants**. It functions as a small, open economy. Reliance on the country's primary resources without resort to protectionism was among the factors that enabled Paraguay to avoid the extreme macroeconomic instability, including hyper-inflation, experienced elsewhere in Latin America over the past 50 years; but as a result, the country's economic activity still relies mainly on agriculture, informal trade, mainly with Argentina and Brazil, and, since the late 1970s, hydroelectric power generation.

3. **In 1989, Paraguay emerged from 35 years of authoritarian rule, burdened with a complex legacy of debilitated institutions, a dwindling stock of human capital and a severe lack of transparency in many of the country's public and private sector institutions**. More importantly, poverty and inequality remained as defining characteristics of Paraguay's economic and social landscape. In 2002, 16.4 percent of the population was living with less than $1 a day while the country's Gini coefficient, a measure of income distribution, stood at 0.58, one of the lowest in the region.[3] This scenario is further exacerbated by the perception both inside and outside the country of pervasive corruption and lack of rules. International surveys and research conducted at multilateral institutions have highlighted this issue. A recent example is the WB's 2005 Country Policy and Institutional Assessment, which ranks Paraguay 24 out of 28 countries in the region in its overall rating.

4. **In August of 2003, President Nicanor Duarte Frutos took office after an electoral process that was viewed as the best since 1989.**[4] At the outset, the new government garnered broad political support around a reform package that included a specific legislative agenda. Following his inauguration, the economic team negotiated a stand-by agreement with the IMF, the first since 1958, and obtained emergency financing from the WB and the Inter-American Development Bank (IDB). As a result of these actions, the country's macroeconomic situation began to stabilize, and a default scenario was averted.[5] Preliminary figures for 2005 show a positive fiscal balance for a second consecutive year and improvements in the government's efficiency.[6] Nevertheless, a high priority is still assigned to broadening the country's tax base, which at 12 percent of GDP is still small compared with the rest of Latin America. The

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1 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, as well as related interpretations.

2 These are issued by the International Auditing and Assurance Standards Board within the International Federation of Accountants (IFAC).

3 World Development Report 2006, The WB. Pages 278 and 279. Data available for 20 countries. Only Bolivia and Brazil show lower indices than Paraguay.

4 Electronic voting was introduced for 45 percent of registered voters and election results for this group were known less than an hour after the polls closed.

5 Also significant was the rescheduling of US$ 138 million of government bonds placed with local banks.

6 Revenue collection increased by 41% in 2004 and an additional 12% in 2005. In addition, the number of registered taxpayers has increased by 15 percent.

improvement of public sector governance remains a high priority as well. A successor stand-by agreement with the IMF was under negotiation at the time this report was prepared.

5. **Paraguay is a member of Mercosur, the regional economic zone established in 1991 with Argentina, Brazil and Uruguay,[7] however, the country is seeking to expand its economic ties with other partners**. So far, Mercosur has made limited progress in becoming the rules-based common market it aspires to be. This has made the integration of the two smaller economies, Uruguay and Paraguay, particularly difficult. Nevertheless, it is widely recognized in Paraguay that Mercosur is a reality and that regional integration is desirable. Beyond Mercosur, Paraguay has been seeking closer commercial links with the US - currently its third largest market - and Europe.

6. **Paraguay's financial sector has been experiencing stability after almost eight years of recurrent crisis.** Starting in 1995 and culminating in 2002 with the collapse of Banco Alemán,[8] the number of banks and *financieras*[9] dropped from 99 to 27. Estimates of the amount of non-recovered Central Bank liquidity assistance and payments made under the state deposit guarantee scheme related to these banking industry failures range between 10 percent and 12 percent of 2002 GDP.

7. **Banks remain the predominant players in the financial sector, with 77 percent of the aggregate financial assets and 70 percent of aggregate loan portfolios**. *Financieras (*FINs*)* and credit cooperatives (CACs) make up the rest. An important issue in the banking sector is the rapid segmentation of the market. Banks, especially the 11 that are foreign-owned, have significantly scaled down retail operations and focused instead on large corporate clients in the export sector. In turn, retail credit operations have moved to FINs and CACs, whose portfolios have shown greater dynamism. The growing significance of CACs in the financial sector is an issue of particular importance in Paraguay. Both banks and FINs have lost significant ground to CACs, which now hold 14.2 percent of the financial assets and 19.5 percent of loans. Including production cooperatives, which also do significant lending, the cooperative sector's share of loans reaches 25 percent. Paraguay's private sector still suffers from limited access to credit. Loan to deposit ratio in the financial system is 58 percent, down from 84 percent before the crisis. The insurance sector is characterized by an unusually large number of companies (35), most of them local. Total insurance premium income in 2005 amounted to US$120 million approximately, which means that some level of consolidation is expected in the near future.

8. **As in a majority of countries in Latin America, the stock market still plays a limited role in Paraguay.** Trading at the Asunción Stock and Commodities Exchange (BVPASA) remains very low at 0.41 percent of GDP. Market capitalization of $212 million is also low at 3 percent of GDP. However, the market has shown signs of progress in the last 2 years, trade volume has tripled between 2003 and 2005, and half of the 60 listed companies made offerings of equity or fixed income securities.[10] The lack of institutional investors is the main reason why the market remains embryonic. The insurance sector is very small by all standard measures.[11] There

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7 Treaty of Asunción signed on March 26, 1991.

8 Second largest bank in the country, part of the Argentine-Uruguayan conglomerate Grupo Velox and a casualty of the Argentine economic crisis.

9 These are essentially savings and loans companies providing the same services as commercial banks, with the exception of checking accounts and some aspects of foreign trade.

10 Listed companies were granted several incentives, such as income tax holiday for up to 5 years, by laws drafted to promote capital markets. However, the fact that most large companies are still family owned, coupled with the lack of liquidity in the market, has kept the bulk of Paraguay's corporate sector outside the exchange.

11 Premium income as a percentage of GDP is 0.96 percent, and there is no real depth or density. This small market is shared among 35 companies, a highly fragmented industry with no capacity to provide liquidity to the market.

is also a need for new and comprehensive regulatory framework in the pension sector; this is emphasized in the WB's Country Assistance Strategy, and in the IMF stand-by agreement's structural reform agenda. The recent financial difficulties experienced at the banking sector pension fund (*Caja Bancaria)* highlight the fragility of the system, where benefits are paid from the current contributions of active workers, and explain the pension fund system's negligible impact on the development of local capital markets.

9. **State-owned enterprises (SOEs) cover key sectors of Paraguay's economy and account for an estimated 30 percent of public sector expenditures**. The main SOEs include *Administración Nacional de Electricidad, Petróleos Paraguayos*, *Empresa de Servicios Sanitarios del Paraguay* (water and sanitation), *Compañía Paraguaya de Comunicaciones* (which has a monopoly on land lines), and *Industria Nacional del Cemento*. The development of a plan to allow participation of public capital in key public enterprises was set as a performance criterion in the country's stand-by agreement with the IMF which expired in November of 2005. As of the date of this report, this plan was still under preparation, pending the conclusion of external audits performed at Paraguayan SOEs on a one-time basis. A successor arrangement was approved by the IMF Board of Directors on May 30 and it also stresses the need for improved governance in the country's SOE's. In any event, the government needs to have adequate tools to (i) continuously monitor the performance of these companies and (ii) ensure an appropriate level of managerial accountability.

10. **Improving financial reporting and auditing practices and effectively aligning them with international standards will support Paraguay's efforts to increase private investment thereby promoting sustainable economic growth.** The long-term benefits associated with improved corporate accounting and auditing practices include:

- ***An enhanced business climate*** – A business climate that fosters investor confidence and thus can attract foreign or domestic investment requires a high level of financial transparency on the part of private or state-owned companies operating in the domestic markets, and the observance by these companies of sound practices of accountability and governance. These requirements imply a financial reporting regime that provides investors, creditors and other third parties with timely and accurate information for their investment and other business decisions.

- ***Increased transparency in the economy*** – One of Paraguay's priorities includes improving the overall image of the country with regards to transparency and the fight against corruption. The recommendations of this ROSC can contribute to this stated goal by both the public and the private sector in Paraguay.

- ***Reduced risks in the financial sector*** – The banking sector's ability to assess credit risks properly depends largely on the accuracy and reliability of corporate financial reporting. Improving the quality of the financial information provided by enterprises therefore contributes to mitigating the risks for banks and other lenders. In the current circumstances, better and timelier financial information from borrowers can ease liquidity constraints in the banking system.

- ***Greater economic integration on regional and international levels*** – Perhaps most important, by observing financial practices similar to those of its main economic partners and aligned with internationally accepted standards, Paraguay will enhance its ability to integrate its economy in regional and international markets.

- ***Improve governance within the State- owned enterprise sector*** – Improving the financial reporting regime applicable to SOEs will help the government to adequately monitor a crucial sector that covers key areas of economic activity in the country.
- ***Capital market development*** –Paraguay's securities market has been growing over the last three years. Yet further growth and development will require greater confidence on the part of investors, and this can only be achieved if the company financial reporting regime which investors rely upon when making investment decisions can be regarded as timely and accurate.

11. **In this context, the ROSC Accounting & Auditing in Paraguay seeks to support the following three strategic objectives**:

a) Make the business environment more attractive for domestic and foreign direct investment;

b) Improve transparency and accountability in the country's corporate sector including SOEs; and

c) Enhance opportunities for better economic integration with the region and the world.

II. INSTITUTIONAL FRAMEWORK FOR CORPORATE SECTOR ACCOUNTING AND AUDITING

A. Statutory Framework

12. **Overall, the statutory framework for accounting and auditing is fragmented and lacks rules and coherence.** This makes professional practice in the country difficult and entails unnecessary duplication of effort on the part of both the public and private sectors. A large segment of Paraguay's corporate sector operates in an environment where no legally sanctioned standards exist. In the supervised sectors, where for the most part adequate rules are in place, different accounting, auditing and financial reporting standards apply.

Table 1 – Summary of accounting and auditing requirements by types of entities.

Type of Entity	Regulatory Agency	Accounting Standards	Audit Requirement	Publication
Bank	BCP/SIB	BCP-SIB regulations	Yes, by SIB-registered auditor	In gazette / newspaper – **not available electronically**
Insurance Company	BCP/SIS	BCP/SIS regulations	Yes, by SIS-registered auditor	
Listed Company	CNV	CNV regulations	Yes, by CNV-registered auditor	On CNV's website
Cooperative	INCOOP	INCOOP Regulations	Yes, for "Type A" Coops, by INCOOP registered auditor	Planned for 2007: on INCOOP's website
SOE	CGR	**None mandatory**	**None required**	**Not required**
Non-Listed Company	n/a	**None mandatory**	For companies with bank borrowings ≥ 3 million	**Not required**

A.1 Accounting

13. **Paraguay's commercial code (*Ley del Comerciante, 1983*) establishes basic obligations regarding accounting**. Companies, including sole proprietorships, with equity in excess of 1,000 daily minimum wages[12] must carry "proper and regular accounting books." The number of books and the system of accounting is left to "the entrepreneur's judgment" with the exception of a daily ledger and an inventory book which are mandatory.

14. **Tax legislation sets additional requirements for financial reporting by companies subject to corporate income tax.**[13] Article 189 of Law 125/1991, New Tax Regime, includes a broad mandate, giving the MoF's authority to issue regulation on accounting practices, documentation and registration by companies and individuals subject to taxation. This article constitutes the base for Resolution 173 issued in June of 2004, which was a significant step towards improving financial reporting by companies in Paraguay. It became effective in December of the same year, and with the exception of the notes to the financial statements, it requires the preparation and filing of all components as provided in International Accounting Standard (IAS) 1.8.[14] Previously only a specific tax form (*balance fiscal*) summarizing the company's balance sheet and income statement was required.

15. **Later in 2004, Law 2421 of "Administrative Reorganization and Fiscal Adequacy" was enacted to modify the tax regime.** This law aims at fighting informality. It introduces personal income tax in the country, significantly lowers corporate income tax (from 30 percent to 10 percent) and broadens MoF's authority to set accounting standards. Its regulatory Decree 6359 issued in September of 2005 states that "the tax administration, through General Resolutions, may include within the regulatory framework, International Financial Reporting Standards and other Generally Accepted Accounting Principles, as long as they do not conflict with dispositions in the tax law and this decree". As of the date of this report, the implementation of these new standards was still in the planning stage.

16. **As usual elsewhere in Latin America, accounting and auditing in the banking and insurance sectors in Paraguay are governed by specific statutes.** In the case of Paraguay, there are two other sectors whose accounting standards are set by specific regulatory agencies. The National Securities Commission (CNV) is the standard setter for listed companies, and the National Institute of Cooperatives (INCOOP) regulates cooperatives.[15] Statutes in place for each of the four sectors mandate the use of IAS/ IFRS,[16] but only as a complement to the local standards, and in case of conflict local standards take precedence.

17. **Banking laws and regulations provide a clear and comprehensive framework for accounting practices within financial institutions**. The accounting framework is in the process of being strengthened with a view to gradually converging with the Basel II principles of supervision. In terms of accounting basis, banks and other financial institutions are required by law to apply the Banking Superintendency's accounting manual and related regulations for both

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12 As of June 2006, approximately US$7,000.

13 According to Decree 1400/92 these include all type of commercial enterprises as defined by the Law of Commerce as well as all state-owned enterprises.

14 The five components are: (i) balance Sheet, (ii) income statement, (ii) statement of changes in equity, (iv) cash flow statement; and (v) notes, comprising a summary of significant accounting policies and other explanatory notes.

15 This report defines the supervised cooperative sector as the 45 largest cooperatives classified as type A,` which are subject to the full regulatory framework imposed by INCOOP.

16 Referencing Technical Resolutions (TR) issued by the *Colegio de Contadores del Paraguay*. The SIB references TR 1. SIS, CNV, and INCOOP refer to the *Colegio's* TRs in general.

prudential and general-purpose reporting (i.e. a single set of statements is prepared for both purposes).[17] Because of its primarily prudential focus, the accounting manual differs significantly from IFRS which is mainly geared towards investors. A discussion of the nature of these differences and their implications is provided in Para. 47. With respect to reporting, financial institutions must file with SIB and publish their annual financial statements within 120 days after year-end and a full set of financial statements no later than 10 days after the close of each quarter.[18] Financial institutions must use the calendar year as their fiscal year.

18. **CNV Resolution 5 issued in July 1992 establishes accounting regulations for listed companies based on International Accounting Standards effective at the time**. It requires the preparation and filing of all basic financial statements and a specific set of disclosures that includes statistical information and ratio analysis, breakdown of costs and expenses, composition of plant, property and equipment and foreign currency assets and liabilities. Listed companies must file with the regulators and the exchange quarterly financial statements signed by management and the internal control officer or *síndico* (see Para. 27 below). Annual financial statements must be filed with CNV no later than 110 days after year-end and must include an external auditor's report. Efforts are currently underway to update Resolution 5 and to strengthen CNV regulations.

19. **Cooperatives must comply with a special statutory framework which has been revised and updated extensively since the creation of the regulatory agency in 2003**.[19] The General Regulatory and Supervision Framework for Cooperatives is comprehensive and follows a prudential approach, similar to the one in the banking sector. Regulation follows a three tiered approach. The 263 cooperatives in operation are classified into three categories (A, B and C) according to their level of assets, deposits, other liabilities, equity and number of members. The 45 cooperatives in the top tier are subject to the most exacting set of rules, and allowances are made to accommodate the characteristics of smaller cooperatives. Financial reporting is done using a mandatory chart of accounts. Financial statements from cooperatives must be filed annually with INCOOP.

A.2 Auditing

20. **Banks and other financial institutions are required to obtain audited financial statements from their large corporate clients.** The relevant section of Resolution 8, issued by SIB in 1996 applies to companies with aggregate borrowings of US$3 million[20] or more, or above US$1 million with any single financial institution. A new SIB resolution which will become effective in 2008 lowers the overall threshold to US$2.4 million and the single entity threshold to US$0.6 million.[21] To access this segment of the market, audit professionals or firms are only required to be "licensed professionals with an enabling academic degree".

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17 Banking Law (no. 861/96), Art. 103. Detailed requirements are set in SIB Resolution no. 13/94 (*Plan y Manual de Cuentas del Sistema Financiero*).

18 Banking Law, Art. 105. Art. 106 also requires the SIB to publish every quarter a set of financial indicators regarding financial institutions operating in Paraguay. Finally, SIB Resolutions no. 723/95 and 514/96 set a compulsory format of financial statements for annual and quarterly reporting, respectively.

19 Cooperative Law 438/94 and regulatory decree 14052, Law 2157/03 which creates the regulatory agency mentioned in Para. 16, and resolution 499/04. Resolution 360/04 modified by resolution 1090/05 provides a mandatory chart of accounts.

20 The Central Bank's Risk Central consolidates information only from Banks and Finance Companies, so the threshold is applicable to transactions with these institutions.

21 The new thresholds are indexed to the monthly minimum wage, which currently stands at US$214.

21. **All five existing regulatory agencies have issued sector-specific regulations regarding the registry of external auditors**. The CGR registry only sets entry requirements and does not regulate or monitor professional practice. All other registries have written policies regarding independence and definitions of what constitutes a related party. They require periodic information on the composition of the firm's revenues and mandate access to the auditor's working papers for a period of five years after the date of the report. They also set provisions regarding infractions and sanctions. SIB and SIS manuals regarding accounting practice are very detailed and comprehensive. On the other hand, none of them require professional examination as an entry requirement, and only CNV mandates continuing professional development.[22] In all cases, ISA are mentioned as complementary to regulations issued by the respective agency. Mandatory rotation of audit firms is already effective in the banking sector. Rotation of audit firms will soon be applicable also to companies regulated by the SIS, the CNV and INCOOP, after 3 years (2 years for cooperatives). These various requirements are summarized in Table 2.

Table 2 – Requirements for Registration as External Auditor

<table>
<tr><th>Sector</th><th>Academic Level</th><th>Professional Experience</th><th>Rotation</th><th>Term of Registration</th><th>Auditing Standards</th></tr>
<tr><td>Banking</td><td rowspan="3">College degree in Accounting</td><td>4 years</td><td rowspan="2">Firm, 3 years, 1 year cooling off</td><td>None – Periodic evaluation</td><td rowspan="3">Combination of ISA, Colegio's and sector-specific standards</td></tr>
<tr><td>Insurance</td><td>5 years for partners, 3 years for firm</td><td>2 years</td></tr>
<tr><td>Securities market</td><td>3 years</td><td>Firm, 3 years, 2 years cooling off</td><td>None – Periodic evaluation</td></tr>
<tr><td>Cooperative</td><td>College degree in Accounting Economics or Business</td><td>5 years (for signing partner)</td><td>Firm, 2 years, 1 year cooling off</td><td>2 years</td><td>Colegio's and sector-specific standards</td></tr>
<tr><td>SOE</td><td></td><td>5 years</td><td>–</td><td>–</td><td>None specified</td></tr>
</table>

22. **The reformed tax code establishes mandatory audits for companies with revenues equal or above US$1 million,[23] with the possibility of extending this obligation to other categories of taxpayers**. This law is expected to affect a larger number of companies than the banking audit regulation. Moreover, the new tax code, Article 33, states that the tax administration is to establish a registry of external auditors, with similar functions and objectives to the ones currently in place in the supervised sectors.[24] This provision had not been implemented as of the date of this report.

23. **External auditors of financial institutions must be licensed by SIB and must adhere to specific standards on auditing and professional conduct.** The conditions for an audit firm or individual auditor to be qualified by the SIB and the auditing and ethical standards to be applied by that firm of individual are set out in the Manual of Norms and Regulations for an Independent

[22] Minimum 20 hours per year on market-related issues.
[23] The Law grants the tax administration the authority to update this amount annually.
[24] In their comments to the ROSC, the Tax authorities made reference to Resolution No 113 which requires certain tax payers to present a "Report of Tax Payment" that must be emitted by an external independent auditor.

Audit in a Financial Institution (Manual on Independent Audit) issued by SIB through Resolution no. 313/91. The manual is very comprehensive, covering all key aspects ranging from qualification to standards of audit work. Salient features of SIB's Manual on Independent Audit are presented in Box 1.

24. **External audit activities in the insurance sector are thoroughly regulated by SIS Resolutions 241/04 (on the qualification of audit firms and individual auditors) and 242/04 (on auditing standards and reporting).** The two resolutions combined are broadly equivalent to the corresponding regulations on auditing issued by SIB for the banking sector (see Para. 23), although certain differences exist, relating in particular to: (i) sectoral expertise, which is not mandatory for would-be auditors of insurance companies (although it accounts for 10 percent of the total grade as part of the scoring system); (ii) contrary to SIB, SIS cannot refuse registration to an auditor as long as they meet the minimum level of the scoring system; (iii) SIS includes the obligation for external auditors to take a liability insurance policy, which is not present in SIB's regulations; and (iv) SIS requires a heavier level of reporting obligations for insurance company auditors.[25]

Box 1 – SIB's Manual on Independent Audit – Salient Features

External auditors must be qualified by the SIB. In addition to the usual requirements of probity and absence of ex-ante conflicts of interests, the qualification process is based on a scoring system in the four main areas of (i) independence, (ii) professional education, (iii) quality and experience, and (iv) institutional capacity.[26] This system is more sophisticated than most qualification mechanisms adopted by banking or insurance supervisors, covering all key aspects required to evaluate a would-be auditor's ability to fulfill each function. Moreover, the weight of each of the four areas seems appropriate given that actual experience of the banking sector is critical for an auditor to operate effectively.

The qualification system is two tiered, with Category I firms and individuals authorized to conduct audits and related services, whereas Category II firms and individuals can only render related services (i.e. cannot issue an independent audit report). Once qualified, the firms or individual appears on the SIB's Registry of Independent Auditors, which can be accessed by the public. As of the date of this report, 23 audit firms were registered under Category I and 3 individuals were registered as Category II. One application by an individual was pending review. Even though the qualification is based on an objective assessment, the SIB retains the possibility to reject an application at its discretion, which is consistent with its role as supervisor.

External auditors' appointment must be approved by the audit committee. The process for selecting a bank's independent auditor from the SIB registry requires obtaining bids from at least two firms and the endorsement of the bank's audit committee. Banks must set up an audit committee as part of the regulations regarding internal controls; the audit committee is a committee of the board of directors and must include at least two board members with no executive functions.[27] The way the audit committee should interact with the corporation's internal control officer (*síndico*) is not defined.

[25] Separate audit reports are required on (a) the financial statements, (b) solvency ratios, (c) follow-up on prior audits' recommendations, (d) internal controls, (e) evaluation of accounting system, (f) compliance with laws and regulations, (g) tax compliance and (h) information technology system.

[26] A fairly detailed explanation of what the criteria for evaluating the auditors are, and how scores are assigned, is provided in the Manual on Independent Audit. The full text of the Manual / Resolution no. 313/91 can may be accessed at http://www.bcp.gov.py/supban/dnp/dnp00711.htm.

[27] SIB Resolutions nos. 455/99 and 256/2000.

Box 1 – SIB's Manual on Independent Audit – Salient Features, cont'd

Applicable auditing standards substantially correspond to ISA although some key standards are omitted. Chapter III of the Manual provides a fairly detailed discussion of applicable auditing standards in the banking sector, and states that the framework of reference for external auditors is ISA and the International Code of Ethics for Professional Accountants (commonly referred to as the International Federation of Accountants' Ethics Code). The Manual also identifies the individual ISAs to be applied for each caption of the financial statements. Because the Manual was last updated in 2001, it omits several important standards recently issued by the IAASB.[28]

Reporting – In addition to an audit report on annual financial statements and a review report on interim financial statements, the Manual requires a management letter documenting the auditor's assessment of internal controls and the accounting system, as well as the findings of the audit. These documents must be forwarded to the SIB. This Chapter will need to be updated to incorporate the significant changes that the IAASB will be making to in ISA 700, The Auditor's Report on Financial Statements.

Rotation of audit firms is mandatory. The SIB has introduced the mandatory rotation of audit firms and individual auditors after three years, which seems excessively short. This measure has been implemented for the first time in relation to audits as of December 31, 2005. A bank can re-hire a previous auditor after a one-year cool-down period. Compulsory auditor rotation other than the rotation of audit partners and key personnel within an audit firm (sometimes referred to as "external rotation") is a complex issue, one that has stirred some controversy in the very few countries that have adopted it, which include Italy and Brazil. Even without discussing the pros and cons of the notion of external rotation, a three-year period seems too short considering that auditors need to invest considerable efforts to gain a proper understanding of the bank's operational profile, key processes and internal controls. A period of five years would seem much more adequate.

A broad range of sanctions on auditors in case of non-compliance is available. The Manual provides for two levels of sanctions. First, the Board of the Central Bank (BCP) can impose sanctions on any entity under its supervision for non-compliance with banking laws and regulations.[29] Among the cases of non-compliance explicitly considered is the inadequate form or timeliness of the auditor's report. The sanctions vary from reprimand to fines by 1 to 50 minimum salaries depending on the seriousness of the infraction. Additionally, the SIB itself can suspend an auditor temporarily or cancel its registration.

25. **As with banks and insurance companies, external auditors for listed companies and cooperatives must be licensed by CNV and INCOOP respectively**. Both regulatory agencies maintain a separate registry for external auditors which are set to regulate professional practice, provide quality control and issue standards. Both impose similar conditions such as 3 years of experience, and adequate staff and institutional resources. INCOOP also requires 5 years of experience from the professional signing the report and has reached an agreement with CNV to collaborate in qualifying external auditors. CNV resolution 823/94 covers registration and norms for independent audits in listed companies and rules for cooperatives are established in the framework cited in Para. 19.

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[28] Such as ISA 260, Communications of Audit Matters With Those Charged With Governance, ISA 300, Planning an Audit of Financial Statements, 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 545, Auditing Fair Value Measurements.

[29] Per the provisions of Law no. 489, Art. 83, referenced in Chapter VII, para. 22 of the Manual on Independent Audit.

A.3 Publication of Financial Statements

26. **Publication requirements are relatively limited overall and differ significantly from one sector to another, from full publication to none**:

(a) CNV regulation makes financial statements from listed companies readily available, both at the exchange and on the exchange's website. Stakeholders consulted described these companies as elite within the country when it comes to quality and disclosure of financial information.

(b) Banks are required to publish abbreviated quarterly statements and annual financial statements in a newspaper. These statements are not available on SIB's website.

(c) Insurance companies are required to publish their annual financial statements in a newspaper; these statements are not available electronically.

(d) Type-A cooperatives must post a copy of their financial statements at their offices. INCOOP is considering posting these financial statements on its website in the future.

(e) SOEs are not required to publish their financial statements, although some do so voluntarily. One of the companies makes its financial statements available on its website.

(f) There is no publication requirement for non-listed companies.

A.4 Internal controls

27. **Paraguay's Civil Code[30] mandates an internal control mechanism for corporations.** According to Article 1117 of the Code, the internal control function is given to an officer with the title of *síndico.* This officer is charged with a broad range of responsibilities, including the examination and issue of an opinion on the annual statutory financial statements. In the case of listed companies, the s*índico* also signs the quarterly financial statements. This officer is empowered to investigate fraud allegations, can convene special shareholders meetings, and bears joint and unlimited civil and criminal responsibility regarding the exercise of his duties. Paraguayan practitioners and regulators interviewed expressed that the effectiveness of this internal control arrangement is uneven at best. The law only requires the nomination of a "suitable" individual, and *síndicos* tend to rely on the opinion of the external auditors, when available, to fulfill their obligation regarding the company's financial statements.[31]

28. **Financial institutions are required by law to establish an internal control unit and appoint an audit committee**. The head of the internal control unit must be a professional with at least two years of experience in management or finance, and answers directly to the board of directors. Audit committees are composed of at least two board members with no corporate executive functions. This committee supervises the annual work plan, monitors compliance with financial control systems, evaluates risk management policies, and has direct influence on the hiring of external auditors.

29. **Cooperatives elect an oversight board (*junta de vigilancia*), and the largest institutions must create an internal audit unit headed by an officer with experience as a professional auditor.** The oversight board has ample powers to supervise management. It answers directly to the cooperative's membership and must be informed of the internal auditor's yearly work plan. The internal auditor has ample powers to verify financial information,

[30] Law 1138/86 modified by law 388/94.

[31] Most countries in Latin America (e.g. Brazil, Mexico, Uruguay and Colombia) also still have a similar type of internal control officer like the *síndico*.

supervise and recommend improvements to the internal control systems, and evaluate the institution's risk management policies.

B. The Accounting and Audit Profession

30. **The accounting profession in Paraguay is organized under voluntary associations, the largest of which is the Paraguayan College of Accountants (*Colegio de Contadores del Paraguay* or *Colegio*)**. The *Colegio* was established in 1916. It brings together 2,100 professionals,[32] and has national coverage, with offices in the capital and eight other cities. It is affiliated with the Interamerican Accounting Association (AIC) and is a full member of the International Federation of Accountants (IFAC). During 2005, the *Colegio* offered thirty lectures, seminars and other training opportunities, reaching 1,700 participants. The *Colegio's* Professional Board issues Technical Resolutions regarding professional practice in the country. Resolution no. 8 issued 2003 adopted IFRS and ISA. In practice, however, because the *Colegio's* resolutions lack legal backing, international standards are viewed only as guidelines by practicing accountants and auditors.

31. **In March 2005, 150 professionals formed a new organization, the Paraguayan Council of Public Accountants (*Consejo de Contadores Públicos del Paraguay* or *Consejo*)**. The new association developed a strategic plan that calls for issuing and enforcing standards for accounting and auditing, a code of ethics, and regulations for professional licensing that are on par with international practice. The *Consejo*'s affiliation with the AIC was accepted recently, and an application for membership of IFAC is being considered. The *Consejo* recently published a volume of auditing standards and a code of ethics based on international equivalents.

32. **Both professional associations have adopted IFAC's Code of Ethics**. The *Colegio* adopted IFAC's code in 2003 and a sworn statement to uphold this code is a requirement for registration. As mentioned before, the *Consejo* has recently published its code of ethics harmonized with IFAC's. The published code is in essence a Spanish translation with very minor and mainly formal differences such as the omission of paragraph 8.48 which established the effective date of application of the relevant section. The challenge for both associations will be enforcement. The *Colegio*'s regulation contemplates a disciplinary board empowered to suspend or revoke licenses, but no sanctions had been registered as of the date of this report.

33. **Although "Big 4" audit firms have a significant presence in Paraguay, a number of local audit firms hold significant shares of the market**. About 75 percent of banks and most subsidiaries of international groups are audited by one of the Big 4 international audit firms. Local companies and smaller international accounting firms hold the majority in the market of services for *financieras* and SOEs. Outside the supervised sectors there is very little information. Rough estimates by the banking association place at between 100 and 150 the number of companies that prepare audited financial statements in compliance with banking regulation. This number is expected to increase since the applicable regulation is set to change in 2008 (see Para. 20). Such a growing market for audit services will require significant capacity-building efforts within the profession and among local universities, to ensure an adequate level of quality in the professional practice and to support the objective of providing banks with accurate and reliable data on their most significant clients.

[32] Estimates from Paraguay's three main universities place the number of accounting professionals in the market at around 18,000,. about 10,000 of which are estimated to be practicing accountants or auditors.

C. Professional Education and Training

34. **The development of a diverse and competitive higher education sector in Paraguay is recent**. Until the creation in 1960 of the Catholic University, the state-owned *Universidad Nacional de Asunción* was the only one in operation. The Constitution of 1992 and Law 136/93 improved the environment for the establishment of new institutions of higher education.[33] The same law created an oversight body (*Consejo de Universidades)* which has approved 13 new institutions since 1993. Most of these universities offer accounting degrees but there are no minimum content requirements for accounting and auditing courses; as a result, a college degree may not represent the same level of preparation from one university to another.

35. **A national certification agency for higher education was recently established to lead the efforts toward harmonization and improvement of college degrees, but its impact to date has been limited.** The National Agency for Evaluation and Accreditation of Higher Education was created in January of 2003,[34] with the objective of evaluating and accrediting the academic programs offered at local universities. The agency is also charged with producing the technical background for the revision and implementation of improved curricula, but it has struggled against silent opposition and limited resources. Although efforts are ongoing, it is unfortunate that the certification for auditing/accounting and/or business related curricula is not mandated by law.

36. **Entry requirements in the profession fall short of good international practice as codified by IFAC[35] and no professional examination is required.** In this context, professional licenses may be awarded to individuals who have not been adequately prepared to apply IFRS or perform quality audits under ISA. The *Colegio* issues a professional license (*matrícula*), which is a necessary requisite for inscription in the external auditor's registries at SIB, SIS and INCOOP. To improve the licensing process, new regulation was enacted by the *Colegio* in June of 2004, which includes mandatory continued professional development (CPD). For public accountants, the main requirements for matriculation are a college degree, and three years of experience. The annual membership fee is between US$17 and US$34 depending on the type of license. Currently 150 individuals and 33 firms have been issued licenses. The first evaluation of this new framework is scheduled for the end of 2006. The *Consejo*'s rules for matriculation are still in preparation. They have issued a basic license to 180 professionals in 2005. The requirements for this type "C" license are mainly formal, and include a college degree in accounting and documentation issued by the tax authority (*registro único de contribuyente*s) and the city government (*patente municipal*).

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[33] Article 79 of the constitution established that new universities had to be created by law, a power that was previously vested on the executive. As a consequence Law 136/93 "*De Universidades*" was passed, simplifying and clarifying the processes for: (a) the establishment of new universities, (b) the establishment of new careers faculties within an existing university, and (c) the granting of licenses to for new universityies' sites.

[34] Law 2072/03.

[35] International Education Standards for Professional Accountants (IES) No. 1 to 6 issued October 2003.

D. Setting Accounting and Auditing Standards

37. **With the exception of the tax administration which has yet to exercise its legal authority, the law does not designate any institution to set accounting and auditing standards in Paraguay. This impedes efforts to apply IFRS in the country.** Beyond the issue of legally sanctioned accounting and auditing standards, a formal process is needed whereby each existing or future standard is thoroughly reviewed by a group of experts on behalf of all in-country stakeholders, including the accounting profession, the business community, regulators, banks, tax authorities and university professors. Such a process helps to identify difficulties in applying new standards, so that companies, auditors, financial analysts and regulators can adequately prepare to apply IFRS standards as and when they become mandatory. In order for IFRS to be applied, not only should these new, more demanding standards have proper legal backing, but also an official accounting and auditing standard-setting body should be set-up similar to the ones that exist in El Salvador (for both accounting and auditing), Mexico and Peru (for accounting).

38. **In February 1999, the *Colegio's* Professional Board passed its first resolution adopting IAS as the applicable standards in Paraguay.** The Professional Board was formed in compliance with Article 61 of the institution's by-laws and charged with the regulation of professional accounting and auditing practice. The 1999 resolution referenced the 1997 translation by the Mexican Institute of Public Accountants (IMCP) as the applicable text. In July of 2002 the Board issued Technical Resolution No 7, updating the original decision by adopting *International Accounting Standards* as translated in 2001 by the IMCP. Finally in June of 2004, the Professional Board issued Technical Resolution No 8, adopting IFRS, and citing once again the translation by the IMCP but without designating which one. Professional association (*colegiación*) is voluntary in Paraguay, and the *Colegio* has no legal authority over companies. In theory, accountants and auditors affiliated with the *Colegio* are bound by its decisions, but since company managements are responsible for preparing the financial statements, not accountants or auditors, international standards are rarely applied in the country. The fact that the Board's resolutions were not accompanied by an implementation plan further undermined the incentive to adopt international standards.

39. **The *Consejo*'s strategic plan for 2006 includes the preparation and publication of Paraguayan GAAP.** Members of the *Consejo* indicated that they are working on a set that would be based on international standards, but simplified and adapted to the country's business and professional environment. The rationale is that given the absence of a definition of GAAP in Paraguay, and the fact that adoption of IFRS will require a reasonable transition period, something needs to be done in the shortest timeframe possible. This is no doubt a worthy initiative and would be a contribution for professional accountants and auditors. In our findings we discuss the sustainability of this approach to standard-setting.

E. Ensuring Compliance with Accounting and Auditing Standards

40. **Paraguay's criminal laws make no specific mention of accountants or auditors which makes conviction of practitioners difficult.** Article 77 of the commercial code states that company accounting should be entrusted to a licensed accountant and that, together with management, the accountant has joint responsibility over faithful registration of business activities and performance. This is, however, a civil statute, and holds professionals liable only for damages. Tax law views financial statements and tax returns (which must be signed by an accountant) as "sworn statements" and in case of fraud, signatories may be criminally charged, and may be jailed if found guilty. According to prosecutors in the financial crimes division at the

Attorney General's office, there have been many cases in which accountants have been investigated for criminal offenses – mainly cases of fraud – but most of these investigations have ended with a "conditional deferment of procedure". In these cases, "cease and desist" or community service are applied for terms up to three years. If the professional sanctioned complies with these penalties, his criminal record is expunged.[36]

41. **The SIB is charged with enforcing accounting and reporting by financial institutions under a two-tiered approach**. Article 102 of the Banking Law provides SIB with all the supervisory powers it needs to monitor financial institutions' compliance with the banking accounting standards. Under the typical two-tiered structure on-site and on-site supervision is the responsibility of two different departments (*Intendencias*), respectively the Department of Analysis and Norms, and the Inspection Department. The work of internal and external auditors is treated as an important component of the supervisor's work, which explains why these activities are closely regulated (see Para. 20 and 23). The Inspection Department has an annual program of on-site reviews, with a total of 18 visits per year; much of the inspection effort is concentrated on the so-called "priority entities." The SIB has developed a detailed inspection manual, which is similar to an audit manual; however, its overall objectives and approach when conducting off-site and on-site supervision are not documented. The BCP and SIB have imposed sanctions in the past against several auditors, including a cancellation of registration in 2005 for a serious case of non-compliance. Additional sanctions imposed in 2005 by the SIB included a one-month suspension and the revocation of registration of two individuals. However the sanctioned auditor has filed an appeal before a local court. Contrary to common worldwide practice, these sanctions are not disclosed to the public.[37]

42. **The Securities Markets law specifically defines infractions regarding the work of external auditors.** According to Article 187, external auditors are subject to sanction when (i) they fail to perform a timely and professional audit, (ii) they fail to comply with auditing standards causing financial damage to the audited entity or third parties; and (iii) they accept audit engagements beyond their capacity, measured in hours of professional time, and in accordance with good professional practice. Sanctions range from a reprimand to fines and revocation of registration. Language included in Law 1284/98 with regards to application of fines is vague and needs clarification to facilitate enforcement. Where the statutes are clear, sanctions such as suspension from listing are imposed on a regular basis, especially for infractions relating to timely delivery of financial statements and other mandatory information. In other cases, given the country's legal tradition and environment, a sanction can be imposed only after a formal judiciary process, which can be lengthy and cumbersome. The result of a disciplinary action is only published once legal procedures are finalized. These practices do not contribute to transparency in the market.

43. **INCOOP has established a supervision department charged with enforcement of sector-specific regulation.** This department is currently staffed with 25 individuals, 22 of which hold university degrees. The institution has provided training in matters such as auditing of information systems, financial statement analysis, and loan portfolio classification, with parameters similar to those employed by the SIB. Detailed manuals and guides for supervision were being prepared and were expected to be ready before the end of 2006. During 2005, the

[36] A paper with a detailed treatment of this issue was kindly prepared for the team by Ms. Adriana Casatti of the Vouga & Olmedo law firm in Paraguay.

[37] Similar arrangements exist for the insurance sector. Under Insurance Law Article 133, insurance companies that conceal information or provide incomplete information are subject to administrative fines. As regards external auditors, if found in breach of their obligations under the SIS Resolution 241/04, they are subject to suspension for up to two years.

Supervision Department conducted a successful trial implementation of the new accounting rules in all the institutions they supervise, assisting them in bringing their internal systems and procedures up to code. This process will facilitate the transition, especially for those cooperatives in the top tier, which will be the focus of enforcement efforts in the near future.

III. ACCOUNTING STANDARDS

A. Standards as Defined in the Statutes

44. **In the absence of a legal definition of accounting standards, most companies in practice default to tax rules for financial reporting purposes**. Decree 6359/05 contains a series of accounting prescriptions that taxpayers must observe when preparing their tax returns. The main areas of discrepancy with IFRS are as follows:

- *Timing for recognizing liabilities* – Under tax rules, the recognition of liabilities is acceptable only when certain conditions of legal form and documentation are met; in contrast, under IFRS, liabilities should be recognized as soon as there is sufficient evidence that an obligation exists. Therefore, at a certain points in time, tax-based financial statements are prone to omit liabilities that an IFRS-based statement would require. In general, the result is to understate liabilities and overstate the financial position of the firm.
- *Capitalization of certain costs* – Companies are permitted to defer for up to five years certain costs (such as organization, reorganization, start-up), which IFRS would treat as period expenses. (Financial statements users favor the IFRS treatment since the future economic benefits derived from these costs are often uncertain). This practice overstates the assets of the firm and distorts its reported profitability.
- *Provisions on receivables* – Tax law requires a period of three years of delinquency or a formal judgment from a competent authority affecting the debtor (e.g. bankruptcy and general restraint to sell). IFRS requires provisions to be recognized "when observable data comes to the attention of the holder of the asset," which includes significant financial difficulty of the obligor or the probability that the debtor will initiate bankruptcy procedures. This practice has the effect of overstating the assets of the firm and distorting its reported profits.
- *Depreciation of assets* – Decree 6359 classifies property and other fixed assets in eight groups and sets for each one mandatory depreciation rates that do not necessarily reflect the useful lives of these assets. Moreover, it gives companies the choice to start depreciating assets either one month after their purchase, or at the end of the year when the asset was available for use. Additionally, impairment of long-term assets is not a deductible cost for tax purposes, which means it is not usually registered. These practices overstate the value of assets and the financial condition of the firm.
- *Revaluation of assets* – Assets are revalued according to variations in the consumer price index issued by the Central Bank. IFRS mandates that fair value shall be used when it can be measured reliably. The income or depreciated replacement cost approaches are to be used only when there is no information on fair value.
- *Disclosures* – Because tax-based reporting does not seek to provide a comprehensive set of financial information needed by investors, lenders and other third-party decision-makers, it omits a number of important disclosures. This leaves the user uninformed about important financial events that affect the firm and therefore unable to properly assess its financial situation and performance.

45. **These differences limit the usefulness of financial statements for investment and credit purposes.** Generally, investors and lenders, when not fully and reliably informed, place limited confidence in the accounts and assume the worst about the actual condition of the company. These practices might unnecessarily limit the access of Paraguayan firms to credit and long-term funds, especially from foreign sources, or increase local firms' cost of financing. For most of these discrepancies, the effective application of IFRS will require significant effort on the part of accountants (either in the public practice or working for companies) to update their technical knowledge.

46. **Resolution 173/04 introduced a significant improvement in the financial statements presented to the tax authorities, which is currently the only financial statement prepared by most companies.** Previously, companies were only required to file a one-page tax form accompanied by a summary balance sheet and income statement (known as *balance fiscal*) with very limited information, and formats varied across companies and over time. Resolution 173, which became effective on December of 2004, requires companies to prepare and file (i) a balance sheet, (ii) an income statement, (iii) a statement of cash flows; and (iv) a statement of changes in equity, in accordance with specific formats included in the norm.[38] But Resolution 173 does not require the preparation of notes to the financial statements and thus falls short of the intended goal of complying with IAS 1. It does require, among other things, comparative information and the classification of assets and liabilities as current and non-current. Also on the authority of this resolution, the statement of cash flows must be prepared using the direct method, and cash flows are to be classified as operating, investing, or financing activities. These mandates comply with presentation requirements set out in IAS 7. Statements prepared under Resolution 173 still follow tax accounting rules, but its provisions can still be considered an important step forward. For one thing, its requirements will allow for comparative analysis over time and across companies and sectors, which will prove useful for users of these statements, including financial institutions and the tax authority.

47. **Accounting standards in the banking sector differ substantially from IFRS**. Financial institutions are required to apply the SIB-issued Accounting *Plan* and *Manual* when preparing their corporate financial statements, and these financial statements are used both for regulatory (prudential) purposes and to inform shareholders and other external users (Para. 16). The main difference between the SIB Accounting Plan and Manual and IFRS relates to loan loss provisioning. To evaluate loan loss provisions, banks apply a compulsory, SIB-issued matrix with fixed loss rates for six different categories of loans, based on the number of days of past-due payment and the existence of guarantees. This approach differs from the one set out in IAS 39, Financial Instruments: Recognition and Measurement, which focuses on estimated future cash flows based on a more qualitative analysis of the credit risk. In practice, this can lead to significantly different provisions. Although the impact of this difference on Paraguayan banks is not known, knowledgeable persons interviewed as part of this ROSC were of the opinion that it was significant. The detailed methodology for computing loan loss provisions currently applicable is set in SIB Resolution no. 8/92/96 of 1996. A revised methodology with more stringent provisioning rules will come into effect on January 1, 2007. Although the new methodology follows the same approach as the previous one, it is widely considered to result in a provision that is closer to the one IAS 39 would provide. Other significant differences relate to (a) carrying at cost, investment in closely-held companies for which no market value can be verified by the BCP (Accounting Plan, Section 2.2); (b) the valuation of property received as collateral on

[38] The second set of financial statements in compliance with Resolution 173 will be available between April and June of 2006.

loans, and (c) the possibility for banks to capitalize organization costs and "deferred charges authorized by the BCP" (IAS 38, Intangible assets requires these to be expensed).

48. **In the insurance sector, the gap between the standards set in the SIS Accounting Manual and IFRS has been significantly reduced with the issuance of a revised Manual in 2004. Nevertheless, key differences remain.** One major step forward in the process of convergence toward IFRS has been the adoption of the accrual method instead of the cash basis of accounting. Differences with IFRS remain principally with respect to the accounting for insurance contracts and financial instruments; although they have not been quantified, these differences could have a material effect and ultimately will need to be addressed. In the short to medium term, since IFRS 4 is only a transitional standard which should be replaced by a comprehensive standard possibly in three to four years, it would make more sense for the SIS to wait for the new international standard to be issued before substantially modifying its Accounting Manual.

49. **CNV Regulations also differ from IFRS in a number of ways.** CNV regulation allows for items of income and expense to be classified as extraordinary, which is forbidden by IAS 1.85. Revaluation of fixed assets and depreciation follows tax regulation, which does not comply with IAS 16.44). Companies have the choice of using replacement cost for valuing inventories whereas IAS 2 determines it must be the lower of cost and net realizable value. CNV regulations mandate the preparation of consolidated financial statements only when the parent company has majority control (50.01 percent of shares), while IAS 27 contemplates other situations in which control can be presumed and therefore consolidation would be required. There are also differences in the scope and procedures for consolidation. Although listed companies are subject to a fair number of disclosures, CNV-mandated disclosures fall short of the international standards' requirements in most areas. Key areas where additional disclosure is needed include related-party transactions and risk management policies.

50. **Accounting rules for cooperatives treat member shares (*cuotas de aporte de capital*) as equity.** Most cooperatives give the holder of these shares the right to request redemption for cash or other financial instrument upon leaving the institution, which they can voluntarily do at any time. IAS 32 proposes that member shares be presented as liabilities.[39] This has been a matter of debate between the cooperative movement and the IASB, since these shares represent the large majority of the sector's reported equity– 75 percent on average in Paraguay.[40] This debate also highlights the fact that adoption of IFRS in any given country must be preceded by a carefully planned and executed transition and that an institution is needed with the capacity to evaluate new standards or proposed changes in existing ones, before they become mandatory. In the case of Uruguay where IFRS were adopted in 2003, local statutes mandate that member shares be presented as equity. The norms in place for loan loss provisioning represent another significant departure from IFRS. These rules are identical to those established for financial institutions, and therefore differences with IFRS also apply to the cooperative sector (see Para. 47). A matrix similar to the SIB-issued one for banks is used for provisioning for losses on loans and receivables for cooperatives.

51. **The preparation and presentation of financial statements in Paraguay is not geared toward external users.** The differences with IFRS in all sectors are material and make it difficult for investors, especially foreign investors, to evaluate and compare the financial information

[39] See also IFRIC draft interpretation D8.

[40] The World Council of Credit Unions' response to IFIC's D8 (www.woccu.org/lrac/index.php?pid=3#IAS32), acknowledges the point with some reservations, and highlights the need for a 5-year transition period.

presented. Moreover, differences in key aspects, such as valuation, impair the ability of managers to make informed strategic decisions. A high-quality financial reporting regime would better serve the needs of both external and internal users.

B. Compliance with Standards

52. **The ROSC team reviewed the financial statements prepared by 20 Paraguayan companies with a view to assessing actual reporting practices.** The sample of company financial statements as of December 31, 2004 included the following types of entities: (a) 5 listed companies; (b) 3 closely-held enterprises;[41] (c) 9 financial institutions, insurance companies and cooperatives; and (d) 3 state-owned enterprises. The purpose of this review was to assess compliance with applicable standards.

53. **The review of listed companies' financial statements shows a high level of compliance with CNV regulations and confirms the differences with IFRS discussed in Para. 49.** In general the information submitted by listed companies was laid out in a user-friendly manner, and relevant information was easy to find. Each basic statement is presented in a single page and the notes to the financial statements are adequately referenced. However, departures from IFRS noted are significant enough to impair international comparability of financial reporting by listed companies in Paraguay, especially with jurisdictions where IFRS are the applicable standards. The main findings from this review follow:

- Only one company classified items of income as extraordinary that would be in contravention with IAS 1 but are allowed under CNV rules.
- Another company accounted for deferred taxes as established in IAS 12 and reported earnings per share as mandated by IAS 33, even though neither of these practices is mandatory in Paraguay.
- Most companies chose to present their statement of cash flows using the direct method which is the preferred one under IAS 7, in spite of the fact that the indirect method is also allowed under current statutes.
- One company did not comply with CNV statutes by presenting a statement of source and application of funds in lieu of a cash-flow statement.
- The use of tax rules for provisioning, depreciation, and accounting for the effects of changes in foreign exchange rates and asset valuation were the most frequently observed departures from IFRS.
- Other standards directly applicable to listed companies such as IAS 14, Segment Reporting and IAS 33, Earnings per Share are not mandatory under CNV regulations, and are therefore seldom, if ever, applied.

54. **Issues on qualified audit reports point to deficiencies in the application of accounting standards by listed companies.** Out of 48 audits reports pertaining to listed companies and reviewed by the ROSC team, nine of these reports had a qualified opinion. For instance, a soybean exporter had not adequately disclosed losses incurred on futures. IAS 32 mandates full disclosure of risk management policies. Information on related party transactions for two companies was not considered sufficient by the auditors, an issue treated extensively in IAS 24. Other issues mentioned included the capitalization of expenses, inadequate provisions, insufficient evidence to support valuation of inventories, and inadequate disclosure of foreign exchange operations.

[41] The team requested financial statements from 36 closely-held companies. Only three were obtained.

55. **Overall, the quality of financial statements from state-owned enterprises is inconsistent and in need of significant improvement.** CGR does not set accounting or auditing standards, and public financial management laws do not distinguish between accounting standards for the general public sector and for SOEs. In this context, decisions regarding financial reporting by SOEs fall squarely within the powers of each institution's management, which is far from ideal. The financial statements prepared by two of the companies reviewed were good in terms of presentation. All four basic statements and notes to the financial statements were included and comparative information was available, along with an external auditor's report. However, only one of these companies had published its financial statements on its website and the statement of cash flows from the other did not comply with IAS 7. Revaluation, depreciation and provisions were treated using tax rules; therefore substantial departures from IFRS mentioned before are also present in these cases. The third financial statement in our sample was of extremely poor quality. It consisted only of a balance sheet and income statement and therefore could not be properly called a full set of financial statements. These differences in the quality of financial reporting by SOEs are a consequence of the regulatory framework described and should be promptly addressed.

56. **Regarding non-listed companies, none of the companies prepared notes to the financial statements, which are not mandatory, and only one included an audit report**. In this context, evaluation of these statements beyond presentational aspects is difficult, which in turn prevents any conclusion regarding the accounting standards applied. Also, the sample of financial statements reviewed was too small to be conclusive in terms of compliance with Resolution 173/04. Nonetheless, the team compared financial reporting before and after this resolution became effective and the improvement is evident at least in terms of presentation. The format is now standardized, comparative information is presented and, as was the case with listed companies, each of the four basic statements is laid out in a single page which facilitates examination. A large number of public-interest entities[42] in Paraguay are only subject to this level of financial reporting requirements and should be subject to much higher standards and accountability.

[42] This notion is recognized by the EU legislation and international organizations including the IASB. Public interest entities are companies that: (i) receive funds from the public in a fiduciary capacity, including banks, savings and loan institutions, investment funds, pension funds, and insurance companies; (ii) provide essential public services and are subject to public procurement; (iii) are active in strategic sectors in the economy, such as defense and those who operate as monopolies; (iv)are owned by the state (i.e. SOEs); (v) are economically significant to the country as a whole (often defined as other than SMEs). Criteria to determine which companies are economically significant include: total revenues, the number of employees, the amount of assets; or (vi)have issued or have taken legal steps to issue securities on an exchange, or have a large number of shareholders representing a substantial ownership interest.

IV. AUDITING STANDARDS AND PRACTICES

57. **The *Colegio* adopted ISA for the first time in 1999 and has updated this decision twice**. Technical Resolution 2, dated February 1999 adopted ISA as translated by the Mexican Institute of Public Accountants (IMCP) in May 1995. In July 2002, Technical Resolution 7 modified the previous resolution and adopted the translation published that year by the IMCP. Finally, in 2004 the *Colegio* issued Technical Resolution 8 which reaffirmed ISA as the applicable standards for its members and referenced the translation by the IMCP as the source of the norms, but without designating which one. Professionals interviewed mentioned that the text in use is dated January of 2004.

58. **The *Consejo* has recently approved and published auditing standards based on International Standards on Auditing (ISA).** Resolution 7 of the *Consejo* issued in March of 2006 puts into effect a handbook of norms which can be described as a significant contribution to professional practice in Paraguay. The resolution contemplates widespread distribution of the handbook within academic, regulatory and government circles and includes in the relevant appendices examples of reports, engagement letters, and quality control procedures that are tailored specifically for use in Paraguay. The *Consejo*'s standards follow the structure and in large part the content of ISA with the following exceptions:

- The *Consejo*'s version of ISA 220, Quality Control for Audits of Historical Financial Information, follows the previous, not the revised version which IFAC made effective for periods beginning on or after June 15, 2005.
- The *Consejo*'s version of ISA 240, The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements, is not consistent with IFAC's current text. It does not include for example (i) inherent limitations of an audit in the context of fraud, and (ii) professional skepticism. The same can be said for the text in ISA 300, Planning An Audit of Financial Statements, which omits a number of paragraphs present in IFAC's text.
- The *Consejo*'s ISA 700, The Independent Auditor's Report on A Complete Set of General Purpose Financial Statements, follows the previous, not the revised version which will become effective for auditor's reports dated on or after December 31, 2006.
- ISA 701, Modifications to the Independent Auditor's Report is not included. This standard furthers the auditor's responsibility in ensuring that the financial statements are not misleading, even if they comply with the accounting principles mandated by local laws and regulations.
- ISCQ1, Quality Control For Firms That Perform Audits And Reviews Of Historical Financial Information And Other Assurance And Related Service Engagements, is not part of the *Consejo's* standards. Quality control of audit work is a fundamental aspect of the audit practice, both in terms of the quality assurance system that a firm sets up and the quality control procedures applied to individual audit engagements.

59. **Within the sample of non-listed and non-supervised companies, only one set of financial statements had been audited.** In this case, the auditor was a local accounting firm and its report stated that the audit was conducted in accordance with Generally Accepted Auditing Standards (GAAS). One report is not enough evidence to conclude that International Standards adopted by the *Colegio* are not applied at all, but the analysis of audit reports prepared for

companies in the supervised sectors where a large sample was available,[43] allows for better inferences to be made. As for the *Consejo*'s resolution, it is too early for an evaluation of its effect.

60. **As previously noted, SIB, SIS, CNV and INCOOP have issued standards on auditing through the regulations of their respective registries of external auditors**. Regulators have written policies regarding independence and definitions of what constitutes a related party. They require periodic information on the composition of the firm's revenues and mandate access to auditor's working papers for a period of five years after the date of the report. They also set provisions regarding infractions and sanctions. SIB and SIS manuals regarding auditing practice are very detailed and comprehensive. In all cases, ISA are cited as complementary to regulation issued by each respective agency.

61. **Audit reports for listed companies show great diversity when it comes to the definition of the standards applied, making evaluation of compliance difficult.** CNV regulations mandate that the auditor's work must conform to CNV regulations and ISA, and his opinion must state whether the company's financial statements were prepared according to CNV regulations and "IAS*" (sic)*. None of the 48 reports reviewed complied fully with both mandates, and there were any number of variants and combinations found. Thirteen reports made reference to IAS and ISA but no mention of CNV regulation. Accounting standards were described as (i) "Standards in force in Paraguay", (ii) Paraguayan "Generally Accepted Accounting Principles (GAAP)", (iii) "IFRS", (iv) "CNV norms and GAAP"; or simply (v) "GAAP". Auditing standards were described as (i) "Generally Accepted Auditing Standards or GAAS", or (ii) "CNV norms and GAAS". Notably, audits prepared by the Big 4 firms (six reports in the sample) stated that these audits were conducted according to GAAS and the financial statements conform to Paraguayan GAAP. References made to "Paraguayan GAAP" or "Paraguayan GAAS" are particularly ill-defined since there are no specific statutes containing these norms, which again calls attention to the lack of clarity about applicable standards in Paraguay.

62. **In the banking and insurance sectors, auditors referenced the norms of the respective Superintendency but were equally vague when defining the accounting or auditing standards applied**. Only two reports made reference to "IAS" and one to "ISA". Auditors made reference to (i) Paraguayan GAAP and Norms and (ii) GAAS. SIB mandates only a clear reference to its own accounting and auditing standards, so in this respect the reports can be characterized as in compliance with banking regulations. The case is slightly different for insurance companies, where regulations mandate that financial statements must be prepared according to IAS when not in conflict with SIS's statutes. Moreover, auditors must report specifically on the differences between SIS regulations and IAS. [44]

63. **The environment within which financial statements audits are carried-out in Paraguay is not conducive to compliance with ISA.** There are clear problems with the standard-setting and enforcement mechanisms in place. There are four main issues.

a) Practical experience and technical expertise for applying ISA and enforcing IFRS is still relatively limited. The lack of experience stems from the lack of minimum requirements for accounting and auditing curricula at universities, so curricula are therefore not geared

[43] 80 reports were available (out of 212), 48 from listed companies, 21 from insurance companies, 9 from banks and Financial Institutions and 2 from cooperatives.

[44] It is important to note that audited financial statements reviewed from insurance companies correspond to the previous regulatory framework and the new framework is expected to introduce significant improvements

towards the application of IFRS or the use of ISA. Adding to this problem is the absence of compulsory continuing professional education.

b) Financial statements from a large segment of the corporate sector are not published, and there is no institution charged with monitoring the quality of financial reporting. Therefore, non-observance of accounting and auditing standards by companies and auditors respectively are unlikely to be detected by third parties; in turn, practitioners have little incentive to ensure that their clients abide by their financial reporting obligations.

c) With the possible and limited exceptions of the four regulators, no system is in place for quality control outside the audit firms themselves. Note that the *Consejo* has not included ISCQ 1 within its normative.

d) The lack of monitoring and effective sanctions is compounded by the fact that criminal statutes in Paraguay do not directly establish sanctions against accountants and auditors and fraud cases brought to justice have resulted only in disciplinary sanctions.

V. PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

64. **Commercial Banks interviewed expressed concerns about several aspects of financial reporting by their clients**. A large majority of these clients are non-supervised companies and the information received was qualified as poor, lacking comparability even for statements from the same company over time. A full set of financial statements is often unavailable from corporate clients. This negative perception does not improve significantly when focusing on the largest borrowers who submit audited financial statements. The main criteria for loan approval remain the client's character and good name, its track record for debt service and its ability to provide guarantees. This perception is consistent with the lack of rules for accounting and especially auditing applicable to companies outside the supervised sectors. Risk managers agreed that efficient, timely and reliable financial reporting would raise the profile of companies in the country and improve their access to resources in the financial sector.

65. **Although perceptions about listed companies' financial statements are much better, they are still seen as requiring significant improvement**. Listed companies are seen as the country's elite in terms of the quality of their financial information. They are also perceived to comply with all CNV regulations. Given their standard format, financial statements are viewed as comparable across companies and sectors, and consistent from one period to the other. Users expressed the need for a better standard for consolidation of financial statements and additional disclosures, especially in terms of revenues, receivables, cost structure, risk management policies, and transactions with related parties. All of these concerns can be addressed within the framework of IFRS.

66. **Leaders of business associations and executives of brokerage firms expressed their strong support for the new tax law, as a means to tackle informality**. They believe that this law (see Para. 15 and 22), if properly implemented and enforced; will prove to be a major step towards transparency in Paraguay. Owners of brokerage houses commented that in this new regulatory environment, companies were more receptive to the idea of becoming publicly traded. Many large companies have already accepted the challenge of improving the quality of their financial statements and have decided to hire external auditors to review them. These companies have come to understand that the financial resources deployed to face this challenge represent not a cost but an investment in their future, bringing them a step closer to the market. However, for companies outside the purview of regulatory agencies, no legally sanctioned financial reporting regime exists, and the regime in place for listed companies needs to be updated. Failure to take

decisive actions could impair the country's ability to take full advantage of this positive development.

67. **The country's profession suffers from a lack of recognition among the business and financial community.** Although this perception is not uncommon, especially in Latin America, the Paraguayan accountancy bodies are seen as lacking institutional capacity. This perception was also expressed in reference to individual accountants and auditors.

VI. FINDINGS AND RECOMMENDATIONS

68. **Enhancing transparency and accountability in the country's corporate sector will have a positive effect on the country's business climate and improve Paraguay's prospects for economic integration**. All stakeholders interviewed have stated their agreement with the strategic objectives cited but also understand that they represent a significant challenge. Members of the accounting profession struggle daily with the lack of clarity and sometimes plain absence of legally sanctioned statutes on which to base their practice. Regulators want to have accountants and auditors as strategic allies, but have reservations when it comes to the quality of the services provided. Business leaders recognize that improving the image of the country's private sector is an indispensable element to achieve sustainable growth. The government has taken a bold step with the reform of the tax code, which has at its core the objective of broadening the country's tax base. A high-quality financial reporting regime based on a clear and coherent legal and institutional framework is a necessary step in the right direction.

69. **To achieve these strategic objectives, Paraguay's private sector must assume a leadership role, especially when it comes to compliance and disclosure**. The perception of corruption and lack of rules is one of the major obstacles that the country's corporate sector must overcome in order to attract domestic and foreign investment. The arguments against transparency in financial reporting focus on the costs involved and the revelation of strategic information to existing or potential competitors. These arguments, although valid, do not take into consideration that enhancing investor and creditor protection is vital to improving the country's business climate, which in turn benefits all. Also, from the point of view of the entrepreneur, the availability of good information will help to improve strategic planning and execution of complex business scenarios. Recent developments in the country's stock market show that when given a real choice, based on adequate information and the confidence that follows transparency, investors are willing to channel financial resources into the country's companies.

70. **The principal finding of this ROSC is that Paraguay has an incomplete, fragmented and loosely enforced statutory framework for accounting and auditing**. Outside of five supervised sectors which include (i) financial institutions, (ii) listed companies, (iii) insurance companies, (iv) cooperatives; and (v) state-owned enterprises, there are no legally sanctioned standards for accounting and auditing and no enforcement mechanisms. This gap is all the more relevant given that only a quarter of the 200 largest companies in the country belong to a supervised sector.

71. **The specific findings of this ROSC Accounting & Auditing may be summarized as follows**:

- **The regulatory framework regarding supervised sectors is fragmented, with uneven quality of standard-setting, enforcement and compliance with the standards**. As in many other countries, banking regulations have a prudential focus and therefore applicable standards differ significantly from IFRS. The Securities Commission's

accounting standards, although "based on IAS", date back to 1992. In the insurance and cooperative sectors, newly issued accounting rules will become effective in 2006. These rules differ from IFRS. State-owned enterprises are subject to the supervision of the Auditor General of the Republic (CGR), whose role is mostly focused on oversight of procurement and investigation of fraud allegations, and does not set accounting or auditing standards.

- **Rotation of audit firms is required within all supervised entities except SOEs, after periods of two or three years**. This is significantly shorter than commonly observed international practices. It entails a potential loss of valuable knowledge by the auditors of companies' activities, which could have adverse consequences on the quality of the audit.
- **The Civil Code and the Corporations Law require the appointment of an individual in charge of overseeing internal controls within Paraguayan corporations (*síndico*).** This role often overlaps with the work of external auditors, including issuance of an opinion on the financial statements. The *síndicos*' value added to the oversight of the financial reporting process is often seen as limited.
- **Putting in place clear and comprehensive rules and an institutional arrangement that can support an updated statutory framework is a necessary step for improving Paraguay's financial reporting regime.** Paraguay's accounting and auditing statutory and institutional framework should follow a coherent structure that includes (i) an effective standard-setting process, (ii) a rigorous mechanism for licensing accountants and auditors, and (iii) strong, capable institutions to monitor the quality of professional practice and enforce the statutes.
- **Paraguay's statutory framework does not require publication of audited financial statements by all public-interest entities.** Publication requirements exist only for some supervised companies; and they differ significantly from one sector to another. CNV regulation makes financial statements from listed companies available online. Banks, insurance companies and large cooperatives are required to publish abbreviated financial statements in a newspaper with large circulation. SOEs are not required to publish their financial statements, although some do publish voluntarily.
- **Efforts made by the profession to set, disseminate and enforce the use of accounting and auditing standards and a code of ethics by their members have had a limited impact.** The professional associations do not have enough resources and although highly qualified professionals have volunteered valuable time to achieve these goals, such an approach lacks sustainability. International standards for accounting and auditing are constantly evolving. Adoption of these standards requires continued monitoring and evaluation before they can be implemented in any given country. The task of setting standards is a full-time occupation, and the same can be said for the tasks of enforcing standards and effectively imposing a code of ethics for professional practice. Even with significant strengthening and resources, it is difficult to envision the professional associations in Paraguay assuming all of these roles.
- **The quality of university curricula in accounting and auditing in the country is in need of improvement.** Efforts should be made towards harmonization with the International Federation of Accountant's (IFAC) educational standards. In the present context, with the exception of practice in the supervised sectors, a college degree in accounting is the only requisite for a professional accounting or auditing practice. The team interviewed five universities that offer accounting degrees and found great interest in the improvement of accounting education.
- **Each of the five regulatory agencies– SIB, SIS, CNV, INCOOP and CGR– maintains a separate registry for external auditors, causing duplication of effort.**

Each agency has its own set of rules which range from highly detailed, such as those issued by the SIB and SIS, to broad guidelines as is the case with INCOOP. The registries are meant to regulate all aspects of professional practice, provide quality control and issue standards, and therefore impose conditions such as previous experience and institutional capacity, but none requires professional examination or continuing education.

- **The accounting profession in Paraguay has been active in providing opportunities for the professional development of its membership.** The *Colegio's* new licensing regulation requires continued professional development, and specific regulation to this effect was also recently enacted. To support this new requirement, the *Colegio* offered a number of courses and professional seminars to its membership in 2005. Both the *Colegio* and the *Consejo* organize an annual congress of accountants and publish professional papers and magazines.
- **Both professional associations have adopted IFAC's Code of Ethics.** The *Colegio* adopted IFAC's code in 2003 and the *Consejo* has recently published its code of ethics harmonized with IFAC's. The main challenge for both associations will be enforcement.
- **Financial statements are very difficult to obtain from non-supervised companies.** The team selected and contacted a random sample of 36 companies from a list of the 200 largest taxpayers in the country and interviewed CEO's of six companies during the main mission. The response to our requests was extremely limited, which poses the question of availability and transparency of audited financial statements in the country within a group which clearly has public-interest characteristics but for which no publication requirement exists.

72. **Recommendation no. 1: Establish the National Steering Committee (NSC) on Accounting and Auditing, in charge of developing and implementing the Country Action Plan (CAP) for the improvement of accounting and auditing practices in Paraguay.** At the suggestion of the ROSC team, the Ministry of Finance (MoF) convened a meeting in March 2006 of all relevant stakeholders, at the end of the main mission for the ROSC Accounting and Auditing in Asunción. Representatives of the accounting profession, regulatory agencies, the business community and academia attended the meeting. A consensus emerged from the meeting on the importance for Paraguay to ensure that accounting and auditing practices are strong enough to support the aforementioned strategic objectives of increased private investment, better governance and continued integration in the world economy. Experience shows that, in these circumstances, a collegial body with adequate means such as the proposed NSC plays a critical role in ensuring that the necessary reforms and capacity building efforts are achieved. Accordingly, we recommend the following actions be undertaken:

a. ***Through an official act of the MoF, formally establish the NSC, set its terms of reference and appoint its members.*** The membership of the NSC should include the institutions that participated to the meeting at the MoF in March 2006. The functions of the NSC would be as follows:

i. Acting as a qualified sounding board for this report, advising both the government and the team to arrive at the best diagnostic and guidance tool possible;

ii. Once the report is published, assisting in its dissemination, especially in the organization of a seminar in Asunción after the report's publication;

iii. Taking a central role in the roundtable discussions following the seminar and leading in the formulation of the country action plan and its implementation;

iv. Leading the short- to medium-term efforts to improve Paraguay's financial reporting regime addressed in Recommendations Nos. 4 to 7;

v. Fostering a dialogue among in-country stakeholders on some of the longer term issues mentioned on Para. 83; and

vi. Prepare the terms of reference of the Oversight Body (see Para. 73 and 76), whose membership should mirror the NSC's.

b. **Provide adequate resources to the NSC to enable it to carry out its function effectively** – The NSC should have a Secretariat equipped with a small staff to be provided by the MoF. All member institutions are expected to contribute significant time to the preparation and monitoring of the CAP. The NSC should also serve to mobilize donor support to carry out the CAP.

c. **Formulate and implement the CAP –** Once the ROSC Accounting & Auditing is finalized and shortly after its dissemination, the NSC will be responsible for developing the Country Action Plan. The responsibility to implement individual components of the CAP should be assigned to separate thematic working groups.

73. **Recommendation no. 2: Pass a law making IFRS and ISA the mandatory accounting and auditing standards in Paraguay and providing the legal basis for a accounting and audit standard-setting and oversight body.** Immediate legislative action is needed to address the lack of accounting and auditing rules for a large part of the country's corporate sector and to consolidate Paraguay's existing statutory framework. Adopting IFRS as the mandatory accounting standards for all public-interest entities in Paraguay will simplify and clarify the country's financial reporting regime, make financial reporting in Paraguay internationally comparable, boost competitiveness in the private sector and facilitate access to domestic and foreign investment. Introducing the proposed legislation will require (i) ample consultation among stakeholders, (ii) drafting a bill which should take into account the results of the consultation process, contemplate the country's business and regulatory environment, incorporate best practices, and establish a reasonable transition period for implementation; and (iii) an active dialogue between stakeholders and both chambers of congress, in order to get the best legislative result possible in the shortest amount of time.

74. **SMEs should be subject to a specific, simplified set of standards, based on the SME IFRS once these are available.** The IASB has been working since 2003 on a set of "SME IFRS" which are expected to be issued as draft in the fall of 2006. A reasonable transition period is likewise needed in this case.

75. **The new law should also adjust the institutional framework for accounting and auditing in Paraguay to current needs.** The tasks of setting and enforcing financial reporting standards and ensuring quality in professional practice are full-time endeavors. They require strong, efficient institutions endowed with adequate human and financial resources. The current state of affairs, with multiple regulators and registries for the supervised sectors, and no legally empowered institutions to monitor standards or professional practice in the rest of the corporate sector, is in need of improvement and consolidation. The accounting profession, regulators, academia, the business community and the government all have significant individual roles to play, but in key areas of action, the chances for success can be greatly improved through constructive dialogue and effective coordination among all actors. Moreover, the complexity of international financial reporting standards and the difficulty of consistently applying these standards mandate that full adoption should follow a carefully drafted plan and a reasonable transition period, allowing for necessary actions to build capacity within the accounting

profession, regulatory bodies and the business community. These actions can best be undertaken by an institution where all interested stakeholders have a voice.

76. **Recommendation no. 3: Establish an accounting and auditing standard-setting and professional oversight body with cross-sectoral competence. Its governance structure should include all relevant stakeholders and it should have the institutional capacity to undertake the broad range of functions described below**. This model, which has been implemented in other countries, most notably in El Salvador within the Latin American and Caribbean region,[45] is consistent with the global trend toward independent oversight of the accounting profession. It has the advantage of pooling resources from all relevant sectors, and reduces the unnecessary burdens imposed by duplication of effort. The authorities could consider extending its purview to include the public sector given their common needs and to achieve greater economies of scale. A participatory approach may require longer processes of discussion and evaluation, but the time invested pays off by way of a smoother implementation.

77. **The oversight body is envisioned as a small, highly professional institution.** It should rely on in-country stakeholders to discharge certain aspects of its mandate[46] and to achieve financial sustainability. The country could seek donor financing to address the costs of the legislative reform and the initial establishment of the professional oversight body. In the medium to long term, the institution should obtain financial support from the public and private sectors and charge fees for the provision of registration and accreditation services.[47]

78. **The proposed oversight body for accounting and auditing should perform three main roles,** as follows:

(a) ***Setting accounting and auditing standards***. The oversight body should develop adequate capacity to: (i) prepare and disseminate guidelines on the implementation of IFRS and ISA, (ii) participate in the debate that precedes the release of new standards or the modification of existing ones (iii) evaluate the impact on local legislation and professional practice of new or modified standards and develop a plan for their implementation, (iv) ensure that the special needs and characteristics of sectors, such as SMEs are taken into consideration; and (v) cover all issues not specifically treated under international standards and their interpretations.

(b) ***Awarding professional licenses for accountants and auditors***. The body should be responsible for ensuring that entry requirements meet good international practice as codified by the International Federation of Accountants. It should oversee professional matriculation, and should combine the five existing registries for external auditors. It should introduce professional examination and mandatory continued professional development for accountants, a certification process as the basis for the registration, and quality review for renewal of said registration for all statutory auditors.

(c) ***Enforcement of accounting and auditing standards including the use of sanctions***. In this area the proposed institution would play a complementary role to the one being

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[45] The *"Consejo de Vigilancia de la Profesión de Contaduría Pública y Auditoría"* was established with six directors nominated by (i) Ministry of the Economy, (ii) Ministry of Finance, (iii) Banking, Insurance and Securities Market Regulators, (iv) the National Business Association, (v) the country's two accounting associations (Salvadoran Institute of Public Accountants and College of Accountants of El Salvador).

[46] For example, the accounting profession and academia could provide continuing professional education and certification exams, and regulators could assist with supervision and enforcement tasks within the purview of the oversight body

[47] El Salvador's *Consejo de Vigilancia* generates 26 percent of its resources through fees for services provided. The UK's Financial Reporting Council is financed in large part through levies imposed on listed companies that are proportional to their market capitalization.

performed by existing regulatory agencies, focusing its oversight on the professional practice of accountants and auditors. Regulatory agencies should continue to monitor the work of accounting professionals in their respective fields while focusing on their supervised institutions. The initial target for the oversight body should be those sectors that currently have no enforcement mechanism in place. Building capacity at the oversight body for financial reporting monitoring, auditor review and sanctioning will be instrumental for carrying out this role.

79. **Recommendation no. 4: Harmonize regulatory framework for accounting and auditing**. The establishment of the oversight body will require a significant amount of time and effort. This recommendation addresses important issues that can be undertaken by in-country stakeholders (under the leadership of the National Steering Committee as discussed after the Recommendations), as soon as the country action plan is finalized.

(a) ***Develop a certification mechanism for accountants***: The professional bodies, regulators and academia can collaborate to establish higher quality entry requirements for professional accountants, in line with IFAC standards. A certification exam should be implemented as a necessary requisite for obtaining a professional license.

(b) ***Develop a unified process for accreditation and registration of external auditors***: The existing system of multiple registries imposes an unreasonable burden on audit firms. There is no formal process of communication between registries, so it is possible that an auditor suspended in one could still be active in another. A step in the right direction was INCOOP's decision to coordinate its registry with CNV. This effort should be improved and expanded to include all other registries. Moreover, there is no accreditation process in place for auditors outside the supervised sectors, such as those performing audits on the financial systems' largest clients; an issue that will be compounded once the tax law provisions cited in Para. 23 become effective.

(c) ***Harmonize publication requirements for supervised entities***. All supervised companies in Paraguay satisfy the criteria for classification as public-interest entities. Audited financial statements are already available and published in some form by these companies with the exception of most SOEs. Audited financial statements from all supervised companies should be available to the general public online, following the model currently applied by listed companies.

(d) ***Extend the term for mandatory rotation of audit firms to 5 years.*** Leaving aside the merit of compulsory rotation of audit firm, which only a small number of countries have adopted (most notably Italy and Brazil), the period of 2 or 3 years in effect in Paraguay seems too short and goes against the need for certain stability in the auditor's tenure, widely recognized as a factor in audit quality. A period of 5 years is recommended as a minimum; Italy requires 6 years and Brazil 5.

80. **Recommendation no. 5: Improve financial reporting by state-owned enterprises**. These institutions are the quintessential public-interest entities, and currently prepare audited financial statements only on a voluntary basis. Actions in this area include:

(a) ***Monitor financial reporting from SOEs***. The government should create a mechanism to continuously monitor financial reporting from all SOEs and take an active shareholder interest in these companies.

(b) ***Make external audits on SOE financial statements mandatory***. These audits should be carried out on an annual basis and should be financed from the companies' own budget.

(c) ***Make audited financial statements from SOEs available to the general public***. This would greatly increase transparency in these institutions and is an instance where the government could lead by setting a good example.

81. **Recommendation no. 6: Update academic curricula in the field of accounting and auditing to achieve harmonization with IFAC's education standards**. Most universities in Paraguay offer college degrees in accounting and auditing. There are currently no minimum content requirements for these courses. A national certification agency for higher education was recently created, but certification for careers in the accounting/auditing/business fields is not mandated by law. The team met with a number of universities in the country and found great interest in this subject as well as the willingness to tackle this issue directly. The universities will require support for their coordination efforts and technical and financial assistance to achieve the desired harmonization.

82. **Recommendation no. 7: Undertake a comprehensive effort to build capacity for the implementation of an improved financial reporting regime in Paraguay.** The professional associations and academia have already made contributions in this area, and they should be supported and encouraged to assume an even larger role. These efforts should include the following:

(a) ***Train university professors to effectively implement the reformed curricula***. Once curricula have been updated, the new content must be effectively delivered in a sustainable manner in the classrooms. University professors will need training in the new curricula and specifically on international accounting and auditing standards.

(b) ***Train staff at regulatory agencies to effectively enforce the reformed statutory framework***. A new statutory framework creates a special challenge for the institutions charged with enforcement. Professional associations can play a significant role in the design and delivery of training for agency staff.

(c) ***Improve and expand the existing training programs for accountants and auditors***. The professional associations should be strengthened in order to more effectively serve the continued professional development needs of their membership. This is a clear area of cooperation between the professional association and the proposed oversight body for the profession. In parallel, the *Colegio* and the *Consejo* should develop a strategy to reach out to the general business and financial community in order to position the profession as a provider of quality services. This would help to raise the awareness of business leaders on the importance of quality financial reporting in stimulating investment in the private sector.

83. **Other areas of improvement in the institutional framework should be addressed in the long run.** These include in particular:

- ***Clarifying the function of the* síndico *and eliminate redundancy with the external auditor's role***. The current overlap is a source of confusion and redundant costs, especially in financial institutions where audit committees are mandatory. The *síndico* could be relieved of responsibility to issue an opinion on the financial statements, which should be done solely by the auditors.
- ***Harmonizing regulatory standards with IFRS***. The report mentions the significant gaps between accounting regulation in the financial and cooperative sectors and IFRS. Regulators and relevant stakeholders should establish a roadmap for the harmonization with IFRS of existing regulatory accounting principles for banks, insurance companies and cooperatives.

- ***Making financial statements from all public-interest entities available to the general public***. This is always a controversial subject. Relevant stakeholders should initiate a constructive dialogue to analyze the costs and benefits derived from taking this step. The experience of the other Mercosur countries, which do require non-listed companies to publish their financial statements, can be a good reference point for this dialogue

84. **Substantial technical assistance funded by international donors will be needed to support this report's policy-based recommendations**. The content, timing and funding of such technical assistance should be defined during the roundtable discussion to be organized in Asunción.

85. **Applying the recommendations of this ROSC is expected to benefit a wide array of in-country stakeholders**, including:

- ***Private enterprises*** – Increasing investors' confidence in corporate financial reporting will ultimately open new opportunities for local enterprises to access long-term financing at a lower cost.
- ***Local investors*** **–** Full convergence with IFRS and ISA is one of the conditions required to make Paraguay's stock exchange more attractive to investors, especially those with international background. A better environment for new listings and increased levels of trading will enhance investment opportunities for domestic investors.
- ***The local banking sector*** – Increasing the reliability of listed and non-listed enterprises' financial statements will facilitate bank intermediation and help the banking sector better manage credit risk.
- ***The public sector*** **–** Reinforcing SOE accounting and auditing practices is an important component of the public sector's financial management agenda. In addition, the proposed improvement in the local accounting and auditing environment will support the Government's efforts to strengthen the corporate tax system and increase the overall tax take.
- ***Paraguay's accounting and audit profession*** – Introducing quality assurance arrangements and taking vigorous action to enhance technical competence in the accounting profession will give investors and corporate entities greater confidence in the profession. Confidence in turn will lead to increased recognition of the value of services rendered by Paraguayan professionals, which in turn will lift professional earnings and increase their international exposure. Moreover, a unified, transparent and efficient institutional framework for the registration and supervision of external auditors will do away with the redundancy and wastefulness of the current arrangement, which imposes an unnecessary burden on audit firms and regulators. As in the case of the accounting profession, the introduction of quality assurance arrangements will increase businesses and investors' confidence in the work of external auditors, improving their access to an expanding market.