ACCOUNTING AND AUDITING

June 15, 2004

Contents
Executive Summary
I. Background
II. Institutional Framework
III. Accounting Standards as Designed and Practiced
IV. Auditing Standards as Designed and Practiced
V. Perceptions on the Quality of Financial Reporting
VI. Findings and Recommendations

Overview

This report provides an assessment of accounting, financial reporting and auditing practices within the corporate sector in Chile, using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and drawing on international experience and best practices in that field. It sets forth several policy recommendations aimed at strengthening the regulatory framework governing financial reporting by corporate entities and the audit practice.

Chile’s generally accepted accounting principles (GAAP) have been converging with IFRS during the last decade, which led to improvements in the financial reporting by corporate entities. However significant differences remain; for instance, Chilean GAAP fail to require disclosure in certain critical areas such as segment information. As a result, financial statement users are not fully satisfied with the information they are provided. The ROSC Accounting & Auditing therefore recommends that Chile adopt IFRS, allowing for a reasonable transition period that would enable Chilean stakeholders to assess the implications of such change and to prepare adequately to meet the new requirements. With regard to small and medium enterprises (SMEs), there is a need to improve the quality of their financial reporting so as to enhance their access to credits, which could also reduce their cost of capital. This could be achieved by making available to SMEs a simplified set of accounting standards based on existing ones.

Chile’s generally accepted auditing standards (GAAS) are well developed, yet certain steps are needed to align them further with ISA. Strengthening the code of ethics for auditors and other professional accountants in line with that of the International Federation of Accountants is also needed.

More importantly, the lack of an adequate licensing mechanism and a process for conducting quality control of statutory auditors is a cause of serious concern, potentially compromising the robustness of the financial reporting regime. In that respect, this report endorses the accounting profession’s plans to create a licensing system similar to those existing in other NAFTA member countries.

The reports also recommends that the authorities establish an independent auditor oversight mechanism to ensure that statutory auditors fulfill their responsibilities properly, especially once the adoption of IFRS sets more stringent requirements on companies. In that context, the enforcement capacity of the SVS, which has been improved in the recent period, should be further strengthened so as to give it a more proactive role in monitoring issuers’ compliance with financial reporting requirements.

This report was prepared by a staff team from the World Bank (LCOAA), on the basis of the findings from a diagnostic review carried out in Santiago from January to April 2004, under the aegis of the Financial Sector Assessment Program (FSAP). The study was led by Henri Fortin who was assisted by consultant Craig Walter. Jamil Sopher provided assistance with regards to quality review. The ROSC study was conducted through a participatory process involving various stakeholders and led by the Ministry of Finance.
# MAIN ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Abbreviation</th>
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<tbody>
<tr>
<td>AIC</td>
<td>Inter-American Accounting Association</td>
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<td>BCS</td>
<td>Santiago Stock Exchange</td>
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<td>CCC</td>
<td>Chilean College of Accountants</td>
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<td>CORFO</td>
<td>Corporación de Fomento de la Producción</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FECU</td>
<td>Uniform Codified Statistical Form (<em>Ficha Estadística Codificada Uniforme</em>)</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<td>GAAS</td>
<td>Generally Accepted Auditing Standards</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IAASB</td>
<td>International Auditing and Assurance Standards Board</td>
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<td>IAS</td>
<td>International Accounting Standards</td>
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<td>IASB</td>
<td>International Accounting Standards Board</td>
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<td>IASC</td>
<td>International Accounting Standards Committee</td>
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<td>IDB</td>
<td>Inter-American Development Bank</td>
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<td>IES</td>
<td>International Education Standards for Professional Accountants</td>
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<td>IFAC</td>
<td>International Federation of Accountants</td>
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<td>IFRIC</td>
<td>International Financial Reporting Interpretation Committee</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<td>ISA</td>
<td>International Standards on Auditing</td>
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<td>LMV</td>
<td>Securities Market Law</td>
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<td>MoF</td>
<td>Ministry of Finance</td>
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<td>MIF</td>
<td>Multilateral Investment Fund</td>
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<td>NAFTA</td>
<td>North American Free Trade Association</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>PCAOB</td>
<td>U.S. Public Company Accounting Oversight Board</td>
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<td>PIOB</td>
<td>Public Interest Oversight Board</td>
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<tr>
<td>RSA</td>
<td>Company Regulations (<em>Reglamento de Sociedades Anónimas</em>)</td>
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<td>ROSC</td>
<td>Reports on the Observance of Standards and Codes</td>
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<td>SAFP</td>
<td>Superintendency of Pension Funds Administrators</td>
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<td>SBIF</td>
<td>Superintendency of Banks and Financial Institutions</td>
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<td>SEC</td>
<td>U.S. Securities and Exchange Commission</td>
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<td>SIC</td>
<td>Standing Interpretation Committee</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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<td>SOE</td>
<td>State-Owned Enterprises</td>
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<td>SVS</td>
<td>Superintendency of Securities and Insurance</td>
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<td>U.F.</td>
<td><em>unidad de fomento</em> (equivalent to US$ 27 approximately)</td>
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EXECUTIVE SUMMARY

Summary of Observations

1. The assessment of accounting and auditing practices in Chile is part of a joint initiative of the World Bank and the International Monetary Fund (IMF) to prepare Reports on the observance of Standards and Codes (ROSC). The main purpose of this ROSC assessment is to assist the government of Chile in strengthening the private sector’s accounting and auditing practices and in enhancing financial transparency in the corporate sector, as a means to support Chile’s primary development objective of maintaining sustained levels of FDI and deepening the integration of its economy on an international level.

2. The main findings of the ROSC assessment of accounting and auditing practices in Chile are presented hereafter:

   • Private sector financial reporting and auditing standards are established by four different entities: the Chilean College of Accountants (CCC), the Superintendency of Securities and Insurance (SVS), the Superintendency of Banks and Financial Institutions (SBIF), and the Superintendency of Pension Funds Administrators (SAFP), with some degree of coordination among these four entities, although the existence of multiple sources of accounting principles invites certain confusion on the part of the users.¹

   • Chilean generally accepted accounting principles (GAAP) have been converging with International Financial Reporting Standards (IFRS) over the last decade and are well developed. However, significant differences and omissions vis-à-vis internationally recognized standards remain, which limit the comparability and usefulness of these statements with those produced using international standards.

   • The SIBF has decided to adopt IFRS as the standards to be applied by all financial institutions for statutory reporting in Chile. This will facilitate the financial reporting process for Chilean banks who operate abroad, and contribute to their increased competitiveness.

   • Under the current arrangements, accounting standard-setting in Chile does not follow due process as broadly as internationally recognized accounting standard-setting,² and is less open to stakeholders outside the profession.

   • Only open companies and entities in the financial sector are statutorily required to have their financial statements audited and to publish them. A significant share of the Chile’s corporate sector is not subject to any audit and/or public filing obligations.

   • Audited consolidated financial statements of Chilean listed companies and certain other public-interest entities are easily accessible to investors and the public. However, investors tend to refer instead to information published yearly in the United States, when available, as they consider it to be more complete and accurate.

¹ On an international level, financial statement users would normally expect that a unified set of financial reporting principles that applying to all entities reporting entities.
² e.g., IFRS or US Generally Accepted Accounting Principles.
The accuracy and reliability of the financial statements issued by small and medium enterprises (SMEs) are viewed by most users as inadequate, mostly due to the lack of a financial reporting framework adapted to their characteristics, and to the absence of regulatory supervision of SME financial reporting. This is detrimental to SMEs’ access to credit and to long term capital.

While Chilean auditing standards and professional code of ethics produced by the CCC are broadly in line with their international counterparts, they lack specificity and do not cover important issues. This can hamper the ability of external audits to ensure that the financial statements are accurate; it can also lead to misunderstandings by auditors regarding issues of conflicts of interest.

The requirements to qualify as a statutory auditor for listed companies are insufficient, especially as they do not include professional examination. Therefore, some statutory auditors may not have acquired adequate technical knowledge and professional competence to properly fulfil their duties.

The audit practice is not actively regulated by the profession’s representative body or the regulatory agencies. This, added to the weak licensing arrangements noted above, represents a risk for the quality of the audit practice.

A statutory auditor may own up to 3% of the shares of a company it audits, which can adversely affect its independence.

A vast majority of Chilean corporations have adopted December 31st as their fiscal year-end, mainly because tax authorities require tax returns to follow the calendar year. The implication is that firms have to hire a large number of marginally qualified temporary personnel to carry-out a large part of the audit work, with the risk of not applying adequate supervision by experienced practitioners.

The recently introduced comités de directores have had a positive effect on the governance of large companies and in building investor’s confidence. The comités focus primarily on issues of related-party transactions and protection of minority shareholders, which are very significant governance issues within the large Chilean corporations. However, they are seldom allocated the necessary resources to dedicate sufficient time to the oversight of the financial reporting and auditing process.

The SVS has recently increased its capacity for enforcing financial reporting requirements. However, this capacity still needs strengthening in view of the growing sophistication and complexity of the financial reporting standards, and especially given the recommended adoption of IFRS for listed companies and other regulated entities.

Companies are not required to invite auditors to attend the annual shareholders’ meeting, and in practice auditors seldom attend the annual meeting. This would contribute to reinforcing minority shareholders’ ability to voice any concern and seek clarification regarding the financial reporting, and would improve investors’ confidence in the country’s corporate system.

Legislation on capital markets has been reinforced in 2001 and is due to be strengthened in the near future, including on financial reporting and audit aspects.
Recommendations

3. The recommendations arising from the assessment of existing accounting and auditing practices will be discussed during a workshop in Santiago with the authorities and Country stakeholders. A Country Action Plan will be developed at that time, identifying specific activities to be undertaken for the implementation of the ROSC recommendations, under the supervision of the Ministry of Finance (MoF) and possibly with the assistance of the World Bank and other international development partners. Recommendations coming out of the ROSC assessment include the following:

4. The authorities should extend statutory auditing and public disclosure requirements currently applicable to listed companies to a wider range of enterprises with public benefit characteristics on account of their size or type of business activities, as a means to bring more financial transparency in the corporate sector.

5. IFRS should be adopted as the mandatory accounting standards for all public-interest entities in Chile, after a reasonable transition period that would allow Chilean stakeholders to assess the implications of such change and to prepare adequately to meet the new requirements. Early adoption of IFRS should be encouraged during the transition, and Company law should be amended to provide legal backing to the use of IFRS for statutory financial reporting.

6. The authorities should seek to establish a Chilean Accounting Standards Board (CASB) as the only body officially empowered with setting accounting standards for general-purpose financial reporting in the corporate sector.

7. The CASB, once established, should develop simplified accounting standards and financial reporting obligations for SMEs. This would help SMEs improve the quality of their financial information and therefore facilitate their access to financing.

8. A public oversight board for statutory auditors should be established by Law. It would have the following function: a) qualification of statutory auditors b) setting professional related standards; c) enforcing those standards through on-site inspections and disciplinary proceedings and d) reporting to the public. The oversight board would be governed by a majority of non-practitioners and would maintain close coordination with the Superintendencies. It would allow to ensure that auditors have adequate capacity to carry-out their function and that the public and interested parties enjoy adequate protection against misstated financial information.

9. The authorities should support the CCC’s initiative to establish a certification process for public accountants consistent with standards issued by the International Federation of Accountants (IFAC), by recognizing it as the basis for licensing statutory auditors.

10. The law should strengthen the role of the comité de directores including by requiring it to report annually to the shareholders and giving it adequate resources to effectively execute its oversight function of the financial reporting process.

11. Regulatory agencies’ capacity for enforcing financial reporting requirements, especially at SVS, should be increased. Regulators should have the resources to perform in-depth analysis of corporate financial statements, conduct on-site inspections of companies, and reviews of auditors.
The staff of regulatory agencies will also need to receive training so that they would be in a position to effectively enforce compliance with IFRS in the future.

12. Academic curricula in the field of accounting and auditing, as well as professional education and training, should be strengthened in line with IFAC’s education standards. Professional accountants should be required to follow training programs to improve and update their knowledge of the standards and best practices in the field of accounting and auditing.

13. The authorities should consider requiring all public interest companies to make their audited, unabridged financial statements publicly available before the annual general meeting, either through the internet or by providing copies free of charge, so that shareholders could be better prepared to decide on the approval of these statements.

14. Company law should require that statutory auditors be available to answer questions from any shareholder on the financial statements at the annual meetings of any public interest entity. This would serve to further legitimize and strengthen the role the external audit plays in the corporate governance system.

15. Company Regulations should be amended to prohibit auditors from owning any shares in a company whose financial statements they audit; the current 3% threshold for allowing such shareholding should be eliminated.
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<th>Action</th>
<th>Priority (see footnote)</th>
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<td>1. Extend statutory auditing and public disclosure requirements currently applicable to listed companies to a wider range of enterprises with public benefit characteristics</td>
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<td>MoF</td>
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<td>2. Adopt IFRS as the mandatory accounting standards for all public-interest entities in Chile, after a reasonable transition period</td>
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<td>SVS</td>
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<td>3. Early adoption of IFRS should be encouraged and the Company law should be amended to provide legal backing to the use of IFRS for statutory financial reporting</td>
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<td>SVS</td>
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<td>SVS</td>
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<tr>
<td>5. Develop a simplified accounting standards and financial reporting obligations for SMEs.</td>
<td>2</td>
<td>CASB</td>
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<td>6. Establish by Law a Public Oversight Board for statutory auditors</td>
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<td>7. Support the CCC’s initiative to establish a certification process for public accountants</td>
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<td>MoF, Oversight Board</td>
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<td>8. Strengthen the role of the <em>comité de directores</em> including by requiring it to report annually to the shareholders and giving it adequate means to effectively execute its oversight function of the financial reporting process</td>
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<td>SVS</td>
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<td>9. Increase regulatory agencies’ capacity for enforcing financial reporting requirements</td>
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1: Bringing Chile’s accounting and auditing practices in line with international standards and best practices
2: Increasing the transparency of the corporate sector
3: Other actions aimed at strengthening the underpinnings of the financial reporting regime
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<td>10. Strengthen academic curricula in the field of accounting and auditing, as well as professional education and training in line with IFAC’s education standards</td>
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<td>MoF, Ministry of Education</td>
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<td>3</td>
<td>MoF</td>
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1: Bringing Chile’s accounting and auditing practices in line with international standards and best practices  
2: Increasing the transparency of the corporate sector  
3: Other actions aimed at strengthening the underpinnings of the financial reporting regime
I. BACKGROUND

1. This assessment of accounting and auditing practices in Chile is part of a joint initiative of the World Bank and the International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting. International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) have been used as benchmarks for this assessment, which included a review of both mandatory requirements and actual practice.

2. In the last decade, the Chilean economy has enjoyed sustained growth, partly as a result of its free trade-based economic policies. This enabled the country to (i) leverage its traditional natural resources, especially copper, and (ii) develop other economic sectors including services. The country’s gross domestic product (GDP) per capita was the second highest in Latin America in 2002, at USD 4,300. Recent years have witnessed the development of a wide range of trade agreements between Chile and its most significant trading partners including the neighboring Mercosur countries, Canada, Mexico, Japan, and, most significantly, the European Union (EU) and the US.

3. Consistent with the free-market policies adopted by Chile over the last three decades, a number of privatizations were undertaken up until 1994. More recently, this policy was expanded to economic sectors dealing with infrastructures such as water utilities and transportation. These policies stimulated foreign direct investment (FDI), which represented on average 7% of GDP between 1994 and 2001—the second largest proportion of FDI in Latin America. A large portion of FDI originated from Europe, and more specifically from Spain. However, the levels of FDI have significantly diminished since 2001, in the context of the global recession and as part of a more specific trend affecting Latin America as a whole.

4. In this context, Chile has sought convergence in its economic and business standards with those of other industrialized nations, including in the field of corporate financial reporting and accounting, and this trend is expected to continue. Chile is currently pursuing full membership in the Organization for Economic Cooperation and Development (OECD); this will provide additional incentive to bring the country’s business standards into line with Europe’s.

5. Chile’s capital markets are among the most developed in Latin America, although the level of trading is still relatively modest. Most large national private corporations and banks are listed on one of the country’s three stock exchanges; a new market (Bolsa Emergente) has been recently created to facilitate access by small and medium enterprises (SMEs). 240 companies are publicly traded on those markets, representing a market capitalization of US$ 73 billion in 2003—proportionately the highest in the region, at 74% of GDP in 2002. As in many Latin American countries, publicly traded companies are often controlled by domestic families, in some cases as part of grupos económicos (conglomerates) that control banks, and industrial and other activities. Additionally, after the privatization of the pension system in the 1980s, privately managed pension funds became the most important institutional investors on the Chilean stock exchanges. From that perspective, the stability of the stock market is all the more important to Chile’s economy, and it underscores the need for Chile’s corporate sector to adopt a robust

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3 Copper accounted for 38.6% of Chile’s exports in 2001; Chile holds 30% of copper world reserves.
4 The Santiago Stock Exchange (Bolsa de Comercio de Santiago or BCS), the Bolsa Electrónica de Chile and the Valparaiso exchange (Bolsa de Corredores).
5 Weighted average of the year – source SVS.
financial reporting system. Another consequence of a market structure with a relatively low free-
float ratio is that the level of trading is comparatively low, annual turnover being of
approximately 8% in 2003. It should also be noted that 22 Chilean corporations currently have
American Depositary Receipts (ADRs) in the U.S. and are therefore subject to the regulation of
the U.S. Securities and Exchange Commission (SEC) with respect to financial reporting and
auditing. The state-owned sector’s importance has been significantly reduced as a result of
privatization, with the notable exception of the copper monopoly Codelco which is considered to
be strategic by the country. For that very same reason, Codelco is subject to the financial
reporting requirements of the stock market regulator. In the financial sector, there are 26 banks
and financial institutions operating in Chile, of which 15 are foreign-controlled—the country’s
largest commercial bank is Spanish. A number of those banks have developed an international
presence, especially in the U.S. As noted above, the private pension system is very important to
Chile’s economy, with total assets representing 60% of the GDP; pension funds are by far the
country’s largest institutional investor, owning 13% of equity securities and 38% of corporate
bonds issued by Chilean publicly traded companies.

6. **One of Chile’s key development challenges at present is to restore its high levels of FDI** \(^6\) **in order to sustain economic growth.** In this regard, the Government of Chile places
particular emphasis on further private investment in infrastructure—including ports, roads,
airports, and electricity—especially through concession. To achieve that objective, Chile needs to
enhance further its investment climate. In that respect, the Government is seeking to improve the
regulatory framework and corporate governance and deepen the financial and capital markets.
From that standpoint, one expected benefit of the ROSC recommendations is for Chile to further
align its corporate sector practices with those of its main North Atlantic Free Trade Agreement
(NAFTA) or EU trading partners, and thereby enhance the country’s attractiveness in competing
for FDI.

7. **Strengthening private sector financial reporting practices could benefit the Chilean
economy vis-à-vis the following improvements:**

   - **Increased levels of trading on the Chilean stock of market.** Chile’s stock exchanges
are seeking to increase the volume of trading and improve access to the market for
medium-sized corporations. This can be achieved only by enhancing investors’
confidence, which requires the availability of financial information that is sufficiently
accurate and complete.

   - **Increased foreign direct investment,** which can be achieved through greater
confidence in, and improved comparability, of financial information.

   - **Enhanced economic integration on an international level,** through further alignment
of Chile’s national standards and codes with those of its main trading
partners—especially the U.S. and the European Union (EU) with whom Chile has
signed free-trade agreement very recently.\(^7\)

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\(^6\) FDI reached a peak in 1999, at US$ 9.4 billion, fell to US$ 3.5 billion on average from 2000 to 2002, and
were down to US$ 2.2 billion in 2003 (source: Central Bank of Chile).

\(^7\) This is especially relevant for financial reporting standards, considering that the EU will require the use
of IFRS by all its listed companies as from 2005; in the case of the U.S., its financial accounting
standard-setter has recently undertaken a rapprochement with IASB for an accelerated convergence
between U.S. GAAP and IFRS.
• Improved access to financing for the SME sector, by providing banks and venture capitalists standardized, useful and reliable financial information.

• Better diversification and investment opportunities for Chilean privately managed pension funds, who will gain access to a broader choice of investment on the stock market as the liquidity of these stock raises.

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

8. Under Chilean Company Law, 8 corporations may be “open” or “closed” (i.e. Sociedades Anónimas Abiertas or Sociedades Anónimas Cerradas), which leads to different financial reporting and auditing obligations. To be considered a Sociedad Anónima Abierta, a corporation must have 500 or more shareholders and at least 10% of its subscribed capital must belong to a minimum of 100 shareholders. Open corporations are statutorily regulated by the Superintendency of Securities and Insurance (Superintendencia de Valores y Seguros or SVS). Closed corporations may voluntarily register with (and be regulated by) the SVS; over 200 of these closed corporations have opted to do so and are presently on SVS’ Securities Registry (Registro de Valores). 9

9. The Company Law requires that all corporations prepare annual financial accounts in accordance with Chilean generally accepted accounting principles (GAAP) and that registered corporations be audited each year by an independent auditor. Non-registered corporations (i.e. closed companies that have not voluntarily submitted the regulation of SVS) are not required to be audited but rather to have their accounts verified by a company-appointed “inspector of accounts”. “Inspectors of accounts” are required to submit “a written report regarding their inspection of the accounting, inventory, and financial statements” at the annual shareholders’ meeting. These inspectors are only required to be “individuals of significant age who have not been found guilty of a criminal offence” and their examination cannot be considered to be the equivalent of an audit. Article 56 of the Company Regulations (Reglamento de Sociedades Anónimas or RSA) requires that auditors apply generally accepted auditing standards (GAAS) and, specifically for open corporations, follow any instruction issued by the SVS on matters of auditing.

10. The annual financial statements of all registered companies must be audited and filed with the SVS within 60 days after the calendar year-end; 10 the SVS then makes these financial statements public on its website. Audited financial statements must be submitted in a standard format, the Uniform Codified Statistical Form (Ficha Estadística Codificada Uniforme or FECU). Non-audited, half-year and quarterly financial statements must also be filed with the SVS within respectively 45 and 30 days after the corresponding period-end. The time limits for filing annual, half-year and quarterly statements used to be respectively of 90, 60 and 45 days

8 Ley de Sociedades Anónimas – Law 18,046 of 1981, modified in 2001 and 2002. The law has been supplemented by Company Regulations (Reglamento de Sociedades Anónimas or RSA) issued by the Government in 1982 (Decreto Supremo 587).

9 Within this report, “registered companies” is used to refer to (i) open companies and (ii) closed companies that have elected to be subject to SVS regulation (i.e., companies that are on the SVS’ Securities Registry).

until 2003 and were shortened very recently. This change is positive insofar as it addresses the needs of the financial statement users for timely access to information. Nevertheless, it adds pressure on companies and auditors to expedite the financial reporting and auditing processes and increases the risk of errors in the financial statements. Companies must also inform the SVS of the fees paid to audit firms no later than February 28th of each year. Open corporations are required to publish their audited balance sheet and income statement in a high circulation newspaper between 10 and 20 days before the shareholders’ annual general meeting in which the financial statements are expected to be presented for approval. The SVS also publishes on its website the full financial statements of all of the companies it supervises (under the FECU format).

11. **Banks, pension funds, insurance companies and other financial institutions are subject to separate financial reporting regulation.** Banks and other financial institutions are regulated by the Superintendency of Banks and Financial Institutions (SBIF) and must follow the accounting rules issued by the SBIF. These include submitting to the SBIF monthly, quarterly, and annual year-end financial reports using the specific SBIF format. Similarly, pension funds and pension fund administrators are regulated by the Superintendency of Pension Funds Administrators (SAFP) and must submit to the SAFP daily, quarterly, and annual year-end financial reporting under a specific format. In the case of insurance companies, in addition to regular reporting requirements, the SVS requires the external auditors to issue an opinion with respect to the quality of internal controls. Pension funds and pension fund administrators have similar obligations vis-à-vis the SAFP.

12. **The SVS, the SBIF, and the SAFP all keep a registry of public accountants authorized to perform statutory audits in their respective areas of supervision.** The requirements set by the SVS for the registration of auditors, whether firms or individuals, are in substance (i) a university degree in accounting and auditing or in business administration, and, (ii) depending on the type of accounting degree, a three- or five-year experience in the field of audit; SVS does not take any proactive measures to review the qualifications of those in its registry other than request that an annual information form be submitted. The SVS does have the authority to suspend or remove firms or individuals from the registry. There are currently several hundred accountants in the SVS registry and, therefore, able to sign audited financial statements; however, as of June 30, 2003, only 46 of the auditors licensed by the SVS actually conducted financial statement audits among registered companies. The SBIF has more stringent requirements for registration, including the fact that only firms are can be qualified and the requirement for previous experience in auditing banks and financial institutions. As a result, only nine firms are currently authorized by the SBIF to audit banks and financial institutions in Chile. The six pension funds are audited by three international firms, two of which are a “Big-4”.

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12 The SVS recognizes three different categories of professionals who may sign audit reports for companies under its jurisdiction. Two of these, *ingenieros comerciales* and *contador-auditories*, are graduates of university programs and the third, *contadores* (accountants) are graduates of technical programs. *Ingenieros comerciales* and *contador-auditories* require three years of work experience to be able to sign audit reports, while *contadores* require five years. For audit firms, those conditions apply to the directors and main partners; there are additional specific requirements with respect to the ownership of the firms; see also paragraph 13.

13 Source: SVS. The SVS is considering proposing amendment to its Regulations on External Auditors regarding registration of statutory auditors, by removing from the statutory auditor registry those individuals or firms who would not have conducted audits in the last two years.
Neither the SVS, SBIF, nor SAFP has a requirement for the rotation of auditors. Shareholders are required to nominate the external auditors each year at the annual shareholders’ meeting; in practice, they validate the choice proposed by the board of directors. Changes of auditors are relatively infrequent.

13. According to Company Regulations, auditors are not permitted to have more than 15% of their revenues come from any one client, directly or otherwise and they are required to be independent of the companies they audit. Independence is defined as “not possessing, directly or indirectly, more than 3% of a company’s subscribed capital”. This is not in line with international best practices on independence requirements, which generally prohibit external auditors, whether individuals of firms, from owning any shares in a client company whatsoever. In practice, international audit firms require and apply international independence requirements more stringent than Chilean requirements. The independence requirements of an “inspector of accounts” are not nearly as rigorous as those of external auditors; while they must not be directors, debtors, or employees of the inspected company, they can in theory have unlimited ownership of the company. Finally, there is no limit on the number of clients any one audit firm or individual auditor may audit.

14. Chilean Law does not require that external auditors attend the annual shareholders’ meeting or be available for shareholders’ questions. Although the law does permit the auditor to attend the meeting, in practice such attendance is quite rare. As a result, minority shareholders may not have the opportunity to seek and obtain clarification from the auditor on issues of concern to them.

15. Since the passing of the capital market law of 2001, open corporations exceeding a certain size are required to have directors’ committees (comité de directores) exercising oversight on various issues including financial reporting. The main functions of the directors’ committee are to: (i) examine the reports from the inspectors of accounts and external auditors and opine on these before the shareholders so that these may approve those reports; (ii) propose the appointment of external auditors and rating agencies to the shareholders, through the Board of directors; (iii) review related transactions and report thereon to the Chairman of the Board (with communication to the shareholders); (iv) review compensation systems and proposals for high-ranking executives; and (v) perform any function they are entrusted with in the company By-laws. The main purpose of creating the comités de directores was to protect minority interests, by providing an ex-ante scrutiny on related-party transactions; for that reason, they are widely acknowledged to represent a significant accomplishment in terms of improving corporate governance. Notwithstanding, a vast majority of these comités are not currently

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14 Very few countries currently mandate statutory auditor (firm or appointed individual) rotation, and there is currently no international consensus on the appropriateness of this measure. Italy has been requiring it for many years. Brazil introduced it very recently in both the banking sector and the stock market. Banking regulators in other jurisdictions have also introduced it. Periodic rotation of the professionals within a firm supervising the audit (i.e. engagement partner and possibly engagement manager) is a much more widespread requirement (it has been applied in the United States for many years and has been adopted by most EU counties).

15 In the banking sector, the SBIF has lowered this threshold to 1%.

16 In the case of audit firms, such prohibition would apply to all employees, irrespective of the fact that they work directly with the client company or not.

17 Company Law, as amended as a result of Capital Market Law of 2001 (Article 50 bis). This obligation applies to listed companies with market capitalization in excess of 1.5 million unidades de fomento (U.F.), i.e. US$ 40 million approximately (one U.F. was equivalent to 16,920 Chilean Pesos or US$ 27 in December 2003).
exercising active oversight of their company’s internal control environment, audit process and financial reporting, mainly due a lack of resources to cover those issues with the sufficient level of depth; as such, they cannot be viewed as equivalent to audit committees. Also, as in a majority of developed countries, active oversight of the financial reporting process was not traditionally a function of directors, and it will require a corporate culture change that can be accomplished with time and awareness. In the financial sector, banks have recently begun to introduce audit committees, on a voluntary basis.

B. The Accounting Profession

16. The Chilean College of Accountants (Colegio de Contadores de Chile or CCC), a voluntary organization, is legally recognized as the body responsible for the development and issuance of generally accepted accounting principles (GAAP) and auditing standards (GAAS). Even so, as previously indicated, the SVS, SBIF, and SAPF have accounting standard-setting powers and some regulatory authority over the accounting profession. The CCC is a member of both the International Federation of Accountants (IFAC) and the Inter-American Accounting Association (Asociación Interamericana de Contabilidad or AIC). Its membership represents 38,000 accountants, an estimated one-third being active members. Nevertheless, affiliation to the CCC is not required for a person to perform accounting activities in Chile.

17. Accountants affiliated with the CCC must conform to its Manual of Ethical Norms, which sets the fundamental principles of conduct for accountants but does not provide guidelines on how to apply those principles. The ethics manual was issued in August 2000. It is a short, principles-based document. The basic principles set forth by the CCC’s ethics manual are similar to those of IFAC’s Code of Ethics for Professional Accountants. Yet the CCC manual is fairly vague, is very rarely prescriptive, and contains such general statements as “the ethical principles that govern the professional conduct of accountants are not substantially different with those that regulate other professions in the society”, which appears to convey the message that public accountants do not have distinctive responsibilities vis-à-vis stakeholders and the society in general.

18. Certain factors tend to constrain auditors’ accountability vis-à-vis the users of financial statements. Chile’s criminal code does not provide for significant penalties against negligent auditors, nor does its civil code facilitate lawsuits against them. Only the largest international audit firms take out professional liability insurance as there is no requirement, statutory or professional, for practitioners to do so. This tends to limit auditor’s accountability and to increase the risk that the quality and extent of the audit work may be inadequate.

19. Three of the four largest international audit firms dominate the market for registered companies and financial institutions. The three largest audit firms in Chile, which are Big-4 members, audit 70% of the companies registered by the SVS. The other Big-4 and three medium-sized firms have achieved a significant presence, representing 17% of registered

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18 These standard-setting powers extend beyond the form of the financial reporting and include accounting standards. In the case of the SVS, there are 25 of these standards, most of which provide details on how CCC standards (Technical Bulletins) should be applied. Nonetheless, SVS accounting standards are more than mere precisions on the CCC Technical Bulletins, and take precedence over these as indicated in note 2 of the FECUs (section on accounting policies).

19 The Company Law and the Banking Law set sanctions against auditors for cases of false or fraudulent representations, or for misrepresentation of accounting records, but not for non-compliance with professional standards.
companies. As previously noted, the SBIF restricts access to the registry of auditors to nine audit firms; and, in reality, most banks and financial institutions are also audited by one of the Big-4.

20. **December 31** is the *de facto* year-end for virtually all Chilean corporations, regardless of their actual economic cycle. Considering that the SVS and other regulatory bodies require audited financial statements to be submitted within 60 days of year-end, this puts a strain on the resources of both the regulator and the audit firms in that the bulk of monitoring and audit work takes place in a short period of time and resources are often idle for significant portions of the year. The end result is that in an effort to limit resource commitments throughout the year, audit firms turn to university students (*asistentes en práctica*) for much of the basic audit work. Generally, these students have little, if any, professional training and given the volume of work also burdening their supervisors, there is a possibility that the quality of audit work performed is compromised.

C. Education and Training

21. **No minimum requirement governs the content of academic curricula leading to the accounting profession.** Each of the nation’s 44 universities that award accounting degrees is responsible for its own curriculum. There is little coordination both between universities and/or with the CCC. There is a voluntary process of university certification underway, which has been validated by the CCC; but at this stage few university programs have agreed to be certified. The largest audit firms tend to recruit from the main universities (e.g. the University of Santiago, and some of the better regarded private universities), but some interviewed representatives from audit firms mentioned that they were experiencing difficulties in identifying recruits with sufficient skills. Neither of the top two universities in Chile, Universidad Católica and Universidad de Chile, offer programs in accounting and/or auditing.

22. **There is neither a professional examination nor a practical experience requirement for registering as a professional accountant in Chile.** The CCC is considering developing a program for the certification of accountants that would be recognized within all NAFTA member countries. This project is supported by the Multilateral Investment Fund, a trust fund managed by the Inter-American Development Bank (IDB). CCC intends to follow the example of the Mexican Institute of Public Accountants, who introduced such certification in 2001.20

23. **Registration as a professional accountant does not entail any continuing education requirement.** Professional education opportunities do exist through the in-house professional development programs of each individual firm—something to which most of the international firms dedicate significant resources. Nevertheless, the absence of compulsory continuing education and training is contrary to international best practice and IFAC’ International Education Standards for Professional Accountants (IES). Accordingly, there is no assurance that auditors have adequately updated their professional knowledge – including on accounting and auditing standards, types of business transactions and corresponding audit risks and approaches – or that they have adequate capacity to fulfill their responsibilities.

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20 The main requirement of the Mexican Institute’s certification is to pass a professional examination organized by the Institute itself. Mexican licensees can practice accountancy in the U.S. and Canada provided they pass additional examinations on national legislation and standards. There is also a 65-hour yearly continuing education requirement to retain the certification.
D. Setting Accounting and Auditing Standards

24. Law 13,011 of 1958 designates the CCC as the body responsible for the determination of Chilean GAAP. Subsequent laws have seen this authority superseded in the case of corporations subject to regulation by the SVS, SBIF, or SAFP. There is no single body of work available documenting the differences between the accounting norms issued by the CCC and those issued by the various regulatory authorities and as such, it is unclear to what extent differences exist. In recent years there has been more of a concerted effort on the part of each of the standard-setters to coordinate the development and issuance of new pronouncements, but this has been more of an ad-hoc than a systematic process. Prior to 1997, Chilean GAAP and GAAS tended to be based upon U.S. standards. Since 1997, Chilean standard setting authorities have been converging their national standards with international accounting and auditing standards, while at that same time retaining some local rules or interpretations of said standards in those instances needing specific reference to the Chilean context.

25. The process by which Chilean GAAP are adopted involves mostly accounting practitioners. The ROSC team was unable to verify details from the CCC on the standard-setting process.21 Based on the information obtained from financial statement users and practitioners, the process to establish the standards does not associate the financial statement users as closely as in the case of U.S. accounting standard-setters or the International Accounting Standards Board (IASB), in a way that would allow the users’ viewpoint to be properly taken into account; and it is little transparent. Also, some country stakeholders pointed to the influence of the Chilean business community over the establishment of accounting standards as an explanation for the perception that Chilean accounting standards are significantly less demanding than international standards.

E. Enforcing Accounting and Auditing Standards

26. The SVS has made recent commendable efforts to enhance registered companies’ compliance with financial reporting requirements in the recent period; still, the SVS’ enforcement continues to need strengthening. Under Law 353822 and the RSA, the SVS has wide powers for enforcing financial reporting requirements from entities under its supervision (registered and/or insurance companies). In the case of the securities market, it has a specialized department dealing with enforcement, the Financial Control Department (División de Control Financiero), with a staff of 31 who have adequate academic and professional backgrounds.23 The SVS has been recently recruiting new personnel to increase its enforcement of financial reporting. The SVS reviews external auditors’ reports on the financial statements for any qualification; it may request, at its discretion, their working papers or any relevant information from a corporation’s records that it deems necessary. By necessity, much of the SVS’ efforts must be dedicated to evaluating and validating formal requirements such as the filing of financial statements and compliance with specific rules (e.g. business combinations). Also, specific attention is paid to checking the standard F.E.C.U. format, which contains extensive, detailed information on the various captions of the financial statements. This tends to divert available

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21 The accounting and auditing standards are set by two ad-hoc committees within the CCC.
23 According to the SVS, half of the staff has university degrees of ingenieros comerciales and monitoring by the Financial control Department includes: checking receipt of FECUs, selective review of compliance with accounting principles, analysis of financial annual reports, and reviewing financial information published in the press by registered companies.
resources from effective and in-depth verification of compliance with financial reporting requirements, on a systematic and preventive basis.

27. It is worth mentioning that 22 Chilean companies representing a substantial portion of the Chilean Stock Exchange’s market capitalization, are currently listed in the US; accordingly these corporations are de facto also regulated by the US Securities and Exchange Commission (SEC), which is widely viewed as a strong enforcer. Consequently, this mitigates part of the risk arising from the SVS’ lack of resources. Nonetheless, most since most Chilean listed companies are only regulated by the SVS, and considering (i) the growing sophistication of the types of transactions the Chilean companies are likely to undertake, whether in the field of trade or financing, (ii) the complexity of accounting treatments, and (iii) the additional risk of errors that shortened reporting time limits entail, strengthened enforcement capacity on the part of the SVS is needed. Strengthening enforcement capacity would include inter alia developing high-level training programs for the personnel of the Financial Control Department with respect to international financial reporting standards.

28. The SBIF and SAFP enforce regulatory accounting and financial reporting standards applicable to banks and other financial institutions and pension fund administrators, respectively. The SBIF has a large staff of relatively experienced personnel with an educational background in business administration or accounting, dedicated to on-site inspection and off-site analyses. On-site inspections take place a minimum of once per year and if necessary, the SBIF has the authority to solicit the working papers of the audit firm or any relevant information from a bank’s internal records that is feels deems necessary. Much like the SBIF, the SAFP has a large staff of relatively experienced personnel with an educational background in economics, business administration, or accounting. On-site inspections are common and the regular review and analysis undertaken is similar to and often more rigorous than annual audit requirements.

29. There are no enforcement mechanisms of professional standards within the public accounting community. The CCC (or Colegio) lacks resources and, since membership is not compulsory to render audit services, there is little incentive for the CCC to impose stringent requirements on its membership. Therefore, the Colegio does not enforce its ethics manual, nor does it monitor in any ways whether the audit practice among its member firms or individuals conforms to CCC standards. The Superintendencies, for their part, do not monitor those issues either. Consequently, compliance with auditing and ethical standards is only ensured through the voluntary internal procedures of the firms, mainly the international ones. A recent corporate scandal in Chile, the Inverlink case, provides an illustration of the risk associated with this absence of regulatory enforcement of professional ethics and quality control standards in the audit practice. That case involved fraudulent transactions among a group of companies, leading to its bankruptcy and significant losses for creditors. It was found after the fact that the company’s external auditor was related to the group it audited, and therefore could not be considered independent. This scandal has undermined the market’s confidence in the mechanisms to ensure financial transparency, including external audits, and represents a set-back for the securities market development and Chile’s efforts to attract private investment.
III. ACCOUNTING STANDARDS AS DESIGNED AND PRACTICED

30. In recent years Chilean GAAP have been gradually converging toward international standards, but significant inconsistencies remain. Despite the CCC and SVS’ commendable efforts for the adoption of new standards in line with IFRS in the recent years, Chilean GAAP still fail to address certain critical issues of accounting and reporting. Also, the Chilean standards are generally less precise and demanding than IFRS, leaving more room for interpretation and judgement by management on accounting treatments and the timing of recognition of such impairment. For instance, with regards to impairment of assets24 (property, goodwill, investments, etc.), impairment testing is required “when evidence exists that would indicate the need for impairment tests”. These differences are important inasmuch as that they: (i) limit the comparability of the financial statements for international investors, who are used to analyzing, and therefore place greater confidence in, information prepared under IFRS or other internationally recognized accounting principles; (ii) have the potential to make the financial information misleading for users (see paragraph 31); and (iii) represent a lesser level of disclosure for users of the financial statements to properly interpret those statements (paragraph 32).

31. In terms of recognition and measurement of the various elements of the financial statements (assets, liabilities, revenues and expenses), significant discrepancies between Chilean GAAP and IFRS exist.25 Principal areas of discrepancy include the following:

- **Foreign investments in hyperinflationary or unstable economies** – In accordance with CCC Technical Bulletin 64 (“BT 64”), the financial statements of foreign subsidiaries whose activities do not constitute an extension of the Chilean operations, or which operate in countries that are exposed to significant risks, restrictions or inflation/exchange fluctuations, are re-measured using the U.S. dollar as the functional currency and then translated into Chilean Pesos, at the year-end exchange rate. IFRS would permit such treatment only if it could be demonstrated that the U.S. dollar is the measurement currency that best reflects the economic substance of the foreign subsidiary’s transactions. Consequently, the accounting treatment provided by BT 64 does not provide an economic representation of these foreign activities within Chilean groups, and in fact it is considered misleading by many financial statement users in Chile.

- **Financial instruments (IAS 32 and 39)** – Chilean GAAP does not require the explicit recognition of investments in financial assets as one of the following three types of investment: (i) held to maturity, (ii) held for trading, or (iii) available for sale. Moreover, investments in marketable securities are valued at the lower of restated cost or market value (i.e. are not necessarily accounted for at fair value).26 Unrealized losses on such

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24 Impairment describes the condition of an asset that, for a variety of reasons—including significant changes in market conditions, technology, or legislation—, has lost value in such a way that its carrying amount (i.e., amount reflected in the balance sheet) becomes less than its value in use or net selling price. IAS 36 is the international standard that specifically deals with all issues involving impairment for most categories of assets.

25 Among the available literature dealing with comparison of Chilean GAAP and IFRS, the standard-setting bodies of NAFTA member countries (including the CCC) have published a survey that summarizes the accounting treatment of the main types of transactions under their respective national GAAP.

26 One of the possible arguments for Chilean GAAP not to require investment securities to be “marked to market” is a concern as to the feasibility of achieving reliable fair valuations, given the relative illiquidity of Chile’s securities market. Nevertheless, under IFRS, the difficulty to evaluate a component of the
investments are reflected in the statements of income, while under IAS 32, *Financial Instruments – Disclosure and Presentation* they would be excluded from the income statement. Furthermore, Chilean GAAP do not require the recognition of the so-called “embedded” derivatives (i.e., specific provisions in a contract of a commercial type that create rights and/or obligations similar to those of a derivative contract) and set less stringent conditions than IAS 39, *Financial Instruments – Recognition and Measurement* for treating such derivatives as hedges. This can lead in some instances costs or gains from the use of derivatives to be unnecessarily deferred to a subsequent year’s income statement.

- **Price-level accounting** – Under Chilean GAAP, financial statements are restated to reflect the effects of the change in price levels on the financial position and results of operations of reporting entities. Price-level accounting is the appropriate treatment under IFRS for companies operating in hyperinflationary economies (which is assessed through various criteria, including measured accumulated inflation exceeding 100% over a three-year period). Chile is clearly not in such a situation\(^{27}\) at the present time and therefore the treatment is not in accordance with IFRS. Other countries in Latin America, including Brazil and Peru, which had applied the price-level accounting method during periods of hyper-inflation and have succeeded afterwards in bringing inflation to relatively low levels, comparable with Chile’s, eventually phased-out this method, mainly to facilitate the financial reporting process for companies and to simplify the presentation of the financial statements for users—especially from the U.S. or Europe.

- **Subsidiaries excluded from consolidation** – Banking operations are not required to be consolidated with non-financial businesses under Chilean GAAP, the justification being primarily the dissimilarity of both the nature of the businesses and the related accounting policies. However, such practice leads to distorting certain of the key financial ratios\(^{28}\) of economic groups that include bank operations, and is not acceptable under IFRS or U.S. GAAP. Moreover, investments in majority-owned subsidiaries in the development stage are recorded by the equity method and “special-purpose entities” are not specifically dealt with in the standards. And thus investments are not necessarily consolidated—which would be inconsistent with international standards since it would mean that the consolidated financial statements would not reflect the full economic entity.

- **Provisions** – Chilean GAAP do not require the existence of an obligation for a provision to be recognized. For instance, with regards to termination benefits, IAS 19, *Employee Benefits*, requires that an entity should recognize termination benefits as an expense “when, and only when: (a) the entity is demonstrably committed to either terminate the employment of an employee or group of employees before the normal retirement date; or (b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy”. Chilean GAAP allow accruing for termination benefits without such conditions being met; in effect, this gives more latitude to management to decide when to record these types of cost and may lead to distort the economic performance of an entity as measured by the income statement—this is precisely the reason why IAS 19 is quite restrictive on when such provisions can be recognized.

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27 Chilean inflation has been quite low for many years (3.6% in 2001, 2.5% in 2002 and 2.8% 2003—source Economist Intelligence Unit).

28 e.g., debt-to-equity ratio, or return on assets.
• **Other significant areas of discrepancy** – A couple other areas worth noting are: (i) the transition period which Chilean GAAP provide regarding the recognition of deferred income tax assets or liabilities\(^{29}\) and (ii) the fact that, prior to the recent issuance of CCC Technical Bulletin 72, acquisitions of companies were accounted for at historical book value, while international standards require them to be recorded at fair value.

32. **Technical Bulletin 56 is intended to address several accounting treatments and disclosures under IAS not specifically dealt with by the CCC Technical Bulletins.** Technical Bulletin 56 is a catch-all pronouncement that essentially states that, absent a specific pronouncement on a matter by the CCC (vis-à-vis a Technical Bulletin), companies are to default to the relevant IAS standard. In practice, Technical Bulletin 56 is not consistently applied, so several critical areas of accounting and disclosure not explicitly covered by Chilean standards are often not treated in locally issued financial statements. These areas include:

- Segment\(^{30}\) reporting – The notes to the financial statements, while containing numerous detailed figures on the balance sheet and specific items of the income statement, seldom provide sufficient data to allow readers of the financial statements to gain a clear understanding of the reporting entity’s economic performance—particularly for those entities with diversified operations in terms of industries and/or geographic regions. This lack of information is not mitigated by the *análisis razonado*, an equivalent of the management discussions & analysis (MD&A) that exist in the U.S. or other OECD countries, that is presented together with the notes as part of the FECU, because the information in the *análisis razonado* is itself generally quite limited; providing such information may not necessarily entail significant additional efforts from companies, as most of the information is in fact essential for the management and would naturally flow out of management information systems;
- Earnings per share;
- Special purpose entities;
- Events after the balance sheet date;
- Financial reporting of interests in joint ventures;
- Discontinuing operations.

33. **In the banking sector, the SBIF-issued standards, which banks are required to apply for general-purpose financial reporting, differ significantly from IFRS.** The main differences in the accounting treatment of banking transactions relate to several factors: (a) The SBIF has issued specific requirements and guidelines on how to compute *allowance for loan*

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\(^{29}\) Under Technical Bulletin 60, *Accounting for Income Taxes and Deferred Taxes* which became effective on January 1st, 2000, the effect on recognizing deferred tax assets or liabilities not recorded prior to that date can be spread over the estimated average reversal periods corresponding to the underlying temporary differences to which those deferred tax assets or liabilities relate.

\(^{30}\) IAS 14, *Segment Reporting* defines a segment as “a distinguishable component of an enterprise” that provides either a) “an individual product or service” (for a business segment) or b) “products or services within a particular economic environment” (for a geographical segment), these individual product or services or economic environments being subject to “risks and returns that are different from those of [other] components (…)”. Typically, the banking subsidiary of a diversified group would likely constitute a business segment; and the geographical segments of a retail group would probably correspond to the subsidiaries in the countries where the group operates, and/or operational units in regions subject to specific competitive or regulatory environments.
losses, including a global provision based on a compulsory matrix with loss rates to be applied to each of five categories of loans provided in the guidelines; additionally, any loan which is past due for over 90 days must be treated as non-accrual and past-due loans for over 24 months must be written off; such an approach may lead to significantly different values than those that would have been obtained applying IAS 39. (b) Under a specific SBIF resolution, investment securities are marked-to-market and the related unrealized profit or loss is excluded from the income statement; under IAS 39, there are three different accounting treatments according to the classification of the instruments; (c) Derivatives as previously discussed (paragraph 31). These approaches are often followed by banking supervisors in other countries for regulatory financial reporting. They create a problem of comparability with international standards for foreign investors; they can also cause the financial statements to not represent faithfully the results and financial position of the bank—especially in the case of loan loss provisioning, as the losses are calculated using rates different from those determined by the bank itself based on historical data and conditions specific to its portfolio of loans.

34. An important recent development was the decision by the SBIF to require all banks to follow IFRS effective in 2007 or 2008. This decision is likely to impact indirectly financial reporting by corporate groups since: (i) diversified groups who own banking operations will have an incentive to apply IFRS to all their activities, so as to avoid the burden of using different accounting standards and having to harmonize them for consolidation purposes; (ii) using IFRS themselves, and seeing the significant changes between IFRS and Chilean GAAP, banks may be inclined to exercise pressure on borrowers to obtain a more reliable information—in many emerging economies, foreign banks tend to require IFRS-based financial statements from local borrowers; and (iii) investors in the Chilean securities markets will see a new advantage in investing in the banking sector, adding pressure on other sectors to adopt IFRS. The SBIF has solicited a report assessing the scope of change involved (with respect to standards) and is expected soon to formalize the timing of the transition in the coming months. SBIF’s decision to adopt IFRS for statutory purposes can have a positive impact on Chile’s banking activities in number a ways. First, since a number of Chile’s banks already follow IFRS or US GAAP as part of their foreign activities or for reporting to their shareholders, this will simplify the financial reporting process for them and further contribute to their competitiveness. Secondly, for those banks that do not currently apply IFRS, it will allow them to further align their practices with those of their competitors on international markets.

35. The ROSC review of financial statements prepared by companies in the enterprise sector as of December 31, 2003 did not find any case of significant departure with financial reporting requirements. A sample of 25 company consolidated financial statements, of which 13 were open corporations, 5 closed corporations voluntarily submitting to the SVS’ supervision, and 6 medium-sized, non-registered enterprises were reviewed for compliance with applicable financial reporting requirements in Chile, mainly in terms of presentation and disclosure. The financial statements of Codeleco (the national copper company), were also analyzed. The main observations arising from the review of these sample financial statements are as follows:

- Accounting standards are described as “Accounting principles generally accepted by the Chilean College of Accountants A.G. (CCC) considering, in addition, standards and instructions issued by the Superintendency of Securities and Insurance (SVS); should differences exist, the latter take precedence”. This wording does not contribute to an

31 In the opinion paragraph of audit reports published with the FECUs, the accounting standards applied in the preparation of the financial statements are in most cases referred to as “principles described in Note 2 [x] and standards issued by the SVS”.

Chile – ROSC Accounting & Auditing 13
image of clarity as to the standards applied, and also conveys the impression that standards may vary according to certain market regulators’ decisions that may not be dictated by purely technical considerations. Ultimately, it does not contribute to foster users’ confidence in the financial statements.

- The absence of clear-cut cases of material departures from applicable standards noted in the FECUs that were reviewed seems to confirm that there is a culture of compliance with the rule among Chile’s business community. Nonetheless, the review noted a relative lack of precision in the information provided in the FECUs, especially on the following aspects: (i) accounting policy for maintenance costs; (ii) the nature and amortization policies of intangible assets; (iii) the potential losses associated with contingencies; (iv) criteria for calculating provisions on receivables or inventories, or impairments charges, disclosure of non-cash transactions, and nature and criteria for computing liabilities relating to severance obligations; and (v) the conditions for the settlement of related-party transactions. This illustrates the need for some of the Chilean accounting standards to be made more precise, and for a stricter enforcement of the standards.

- In general the ROSC team found the FECUs to contain a lot of detailed information and to be fairly well structured, but that the impact of the information provided was somewhat hindered by an excess of data with limited significance and, on the contrary, by the absence of information on certain key aspects, as previously discussed. This was particularly true for the análisis razonado, which in most cases reviewed provided information that was redundant with the rest of the FECU, and failed to present the underlying economic factors that would allow the reader to gain a proper understanding of the company’s financial performance during the reporting period. Additionally, the review noted that in several instances the notes did not cross-reference to the basic financial statements (balance sheet, income statement and cash-flow statement).

- There was also the case of a registered company whose financial statements as of December 31, 2001 and 2002 had been restated in the course of 2003. These restatements had been requested by the SVS because the regulator disagreed with the treatment applied by the company under Technical Bulletin 64 (BT 64, previously discussed in paragraph 32) to a transaction in one of its subsidiaries in Argentina. What is interesting in this case is that it shows the possible shortcomings of BT 64, but also provides evidence that SVS is effectively able to require and obtain such restatements from registered companies.

Overall, Chile’s accounting standards, although well developed, should be further aligned with IFRS and applied in a stricter manner. The shortcomings discussed above are detrimental to the quality of Chilean companies’ financial statements—which is not quite as high as in a number of OECD countries. This explains why, when available, market participants prefer using the financial information issued by Chilean companies for public filing in the US (see paragraph 40). This tends to hamper investment on the stock market and lending to the corporate sector and, ultimately, adds constraints on Chilean enterprises’ access to longer term financing. The fact that most Chilean corporations are closely controlled by local families and that the

32 SVS Circular (oficio ordinario) no. 154 of January 2003. SVS challenged the appropriateness of the classification as a non-monetary liability of deferred rental revenues relating to a long-term lease.
33 The SVS decision was challenged by the company before a first circuit Court and then before an appeals court, but was eventually upheld. See also paragraph 38 on questions relating to the corresponding independent audit report.
existing levels of trading on the stock market are comparatively low creates a disincentive for those corporate groups to disclose more financial information than they currently do. Nevertheless, if Chile’s securities market is to expand—both in terms of number of listed companies and of existing listed shares’ trading levels—more financial transparency will be needed to attract new investors from abroad and to give pension fund administrators incentive to extend their investments to a broader range of Chilean companies.\(^{34}\)

IV. AUDITING STANDARDS AS DESIGNED AND PRACTICED

37. **Chilean auditing standards are well developed but are not up-to-date vis-à-vis ISA in several key areas.** Specifically, Chilean GAAS are silent on the consideration of error and fraud (ISA 240), knowledge of the business (ISA 310, which underlines the importance for auditors to properly identify and understand the company’s transactions and practices as well as events that may have a significant impact on the financial statements), communication with the directors’ committee (ISA 260), initial engagements (ISA 510), and information systems environments (ISA 401). Also, the Chilean standards on quality control are less specific and demanding than ISA 220. Moreover, standards are rarely accompanied by guidance to facilitate their implementation—a situation that increases the chances that a standard may be misinterpreted and/or applied inappropriately. Although available information is insufficient to assess the impact on audit practice of these gaps between Chilean GAAS and ISA, the fact that such important issues are not dealt with by the applicable standards is a reason for concern. Indeed, in the absence of such standards, the external audit process is less proactive in developing a risk-based approach to identifying sources of errors or irregularities in the financial statements. This increases the likelihood that these issues are not properly addressed as part of the audit, and that the financial statements do not fully comply with accounting principles.

38. **Section 101 of the Chilean auditing standards stipulates that, in the absence of a national standard covering a specific matter, auditors should apply the relevant ISA standard.** In theory this catch-all rule appears to obviate, as does Technical Bulletin 56 for accounting principles, the need for specific local pronouncements. However, in the absence of an active enforcement within the auditing profession, Section 101’s application could only be assured through effective internal quality control mechanisms at respective audit firms. In practice, most international firms, especially the largest ones, have made significant investments and assigned considerable resources to ensure the implementation of international auditing standards. Nonetheless, to avoid any ambiguity as to the applicable standards and to facilitate their dissemination within the accounting profession and understanding by users, it would be better to either directly incorporate the missing ISA as a Chilean GAAS, or to adopt ISA altogether. By bringing its auditing standards to the level of ISA, the CCC would contribute to enhance the robustness of the country’s audit practice as a whole; this would mitigate the risk of a gap in the practice between a) the large audit firms subject to outside regulation through their respective international network of affiliation and b) small local firms or individual auditors. Indeed, in the wake of the further concentration within the large international networks (which are now down to four “Big-4”), fostering the development of a local quality audit practice can help maintain an adequate level of competition on the market of audit services, especially for the medium-sized registered companies or banks.

39. **The ROSC review noted certain issues raised in the audit report on two of the financial statements reviewed.** In the case of the registered company discussed at the end of

\(^{34}\) Pension funds invest in approximately 90 of the current 250 listed companies.
paragraph 35, the financial statements as of December 31, 2002 had been restated at the request of SVS. In the meantime, the company had changed its auditor. The newly appointed auditor issued an audit report on the restated 2002 financial statements. In the second paragraph of its report on the 2002 financial statements, the new auditor included a “scope limitation” regarding the fact the financial statements had been re-issued and indicating that “[the] report on the modified financial statements (...) differs from that of the other external auditors (...).” The wording of this report appears to be inadequate in the circumstances, as the issue at stake did not involve the impossibility for auditors to carry-out audit work but rather the position they were to take on the conformity of accounting treatment applied under Technical Bulletin 64. Also, the scope limitation noted in the second paragraph, should have given rise to a qualified opinion. In all, this report is confusing to the readers of the financial statements, especially as it leaves some doubt as to whether the auditor agrees with the treatment followed. For another registered company reviewed, the audit report as of December 31, 2002 contained an opinion qualification for the fact that the auditor had not “obtained, at the date of the report, sufficient evidence (...) on the accounts payable from a related company (...)”. Since the account in question was the only significant one on the balance of that company, the auditor should have in fact acknowledged its inability to conclude and should have presented a disclaimer of opinion.

V. PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

40. Users of financial statements in Chile expressed mixed if not conflicting perceptions on the quality of the financial reporting and their degree of confidence in the financial statements presented by management, examined by the auditors, and reviewed by the regulators. Some users strongly expressed the need for additional information to be disclosed within the financial statements. Specific areas of concern voiced by virtually all those interviewed in the course of the ROSC assessment are: (i) Segment information, and operational information, which would require further disclosures on income statement and improved MD&A; several investors interviewed mentioned that, by comparison, they considered SEC Form 20-F prepared by Chilean companies listed in the U.S. and easily available to the public to be much more informative—although 20-Fs are only available once a year and therefore cannot be an adequate substitute for the information to be provided in Chile on a more frequent basis; (ii) the level of disclosure in the financial statements on sensitive aspects such as derivatives, which is viewed as insufficient; and (iii) certain treatments that clearly depart from IFRS such as the one provided in Technical Bulletin 64 (see paragraph 31). These concerns hamper investors’ confidence and contribute to inhibiting liquidity of the securities market. With regards to SMEs, the accuracy and reliability of their financial information is perceived by bankers as relatively poor, leading to higher cost of financing, or impeding their access to long-term financing, especially through equity markets—the slow development of the Bolsa Emergente, which was meant to enhance SMEs’ access to the stock market, illustrates that difficulty.

35 An independent audit under Chilean GAAS (as under ISA) normally contains the following three standard paragraphs on: (i) description of the financial statements (introductory paragraph), (ii) scope of the audit and (iii) opinion; plus any qualification or specific matters that warrant particular emphasis.
VI. FINDINGS AND RECOMMENDATIONS

A. Findings

41. Chile’s accounting and auditing standards are well developed. Nonetheless, there are certain weaknesses in the regulatory regime underpinning the application of the standards, and the standards themselves need to be aligned with their international equivalents in order to provide a complete and accurate financial information, and to allow investors and other stakeholders to use the information knowledgeably. The principal findings of the ROSC Accounting & Auditing in Chile are as follows:

(i) Private sector financial reporting and auditing standards are established by four different entities: the CCC, SVS, SBIF, and SAFP, with some degree of coordination among these four entities, although the existence of multiple sources of accounting principles contributes to a lack of clarity for the users.

(ii) Chilean GAAP were historically developed on the basis of U.S. GAAP; during the last decade, they have been converging with IFRS. However, significant differences and omissions vis-à-vis internationally recognized standards remain. The lack of certain Chilean standards limits the usefulness of financial statements both for local and international users, insofar as they do not provide complete information on reporting entities’ economic performance. Moreover, remaining differences negatively impact the quality of locally produced financial statements—because Chilean GAAP are less demanding than IFRS, and therefore prone to provide information that is less accurate, complete and/or understandable by users—and limit the comparability of these statements with those produced using international standards. Two of the broader implications are a weakening of investor confidence and, consequently, a constraint in Chilean companies’ access to longer-term financing, most notably amongst SMEs.

(iii) A recent development of importance is SIBF’s decision to adopt IFRS as the standards to be applied by all financial institutions for statutory reporting in Chile. This will facilitate financial reporting process by Chilean banks that operate abroad and contribute to their competitiveness.

(iv) The process of setting Chilean accounting standards entails consultation within the profession and to a lesser extent with stakeholders; it is not as transparent and open to stakeholders outside the profession as those of internationally recognized accounting standard-setters. The process does not ensure that the standards adequately take into account the users’ needs as regards the key characteristics of the financial information (presentation, disclosure, etc.).

(v) Only open companies and entities in the financial sector (banks, insurance companies, etc.) are required to have their financial statements audited. This represents approximately 500 out of the 6,500 large enterprises (grandes empresas) under the Chilean Government’ classification. Although no statistics are available as to the aggregate economic weight of the remaining 6,000 large enterprises and the 13,500 medium-sized enterprises, it can be assumed that a significant share of the Chile’s corporate sector is not subject to audit and public filing obligations.
(vi) Audited consolidated financial statements of Chilean registered companies and certain other public-interest entities are easily accessible to investors and the public, either through SVS’ website in their full version, or in the press in a full or most frequently abridged version. However, investors tend to refer instead to the information published in the U.S. when available, as they consider it to be more complete and accurate.

(vii) The accuracy and reliability of the financial statements issued by SMEs is viewed by most users as inadequate, mostly due to the lack of a financial reporting framework adapted to their characteristics, and to the absence of regulatory supervision of SME financial reporting. This limits SMEs’ access to credit and constrains their ability to access long-term capital.

(viii) While Chilean auditing standards and professional code of ethics produced by the CCC are broadly in line with their international counterparts, they lack specificity and do not cover important issues. This can hamper the ability of external audits to ensure that the financial statements are accurate; it can also lead to misunderstandings by auditors regarding issues of conflicts of interest. Moreover, maintaining national auditing standards and a code of ethics is an unnecessary drain on the resources of local standard setters, particularly when the basic principles underlying the two sets of standards are supposed to be identical.

(ix) The requirements to qualify as statutory auditor for registered companies are insufficient: they mainly consist of a university degree and a three or five-year experience, and no professional examination is required. Therefore, some statutory auditors may not have acquired adequate technical knowledge and professional competence to properly fulfil their duties, thus leading to the risk that the audit is inaccurate or of low quality.

(x) The audit practice is not actively regulated by the profession’s representative body. The regulatory agencies for their part have not put in place a mechanism to monitor statutory auditor’s compliance with applicable auditing standards and independence requirements systematically. This, added to the weak licensing arrangements noted above, represents a risk for the quality of the audit practice.

(xi) Under SVS regulation, a statutory auditor is allowed to own up to 3% of the shares of a company it audits. Even at such low levels, these shareholding relationships can affect adversely the independence of an external auditor.

(xii) A vast majority of Chilean corporations have adopted December 31st as their fiscal year-end, regardless of the reality of their economic cycles, mostly due to the fact that tax authorities require that corporations file their tax returns on a calendar year basis. This puts a strain on the resources of both the regulator and the audit firms in that the bulk of monitoring and audit work takes place in a short period of time and part of the resources are often idle for significant portions of the year. The implication of such concentration of auditors’ workload over a short period of time is that firms have to hire a large number of marginally qualified temporary personnel to carry-out a large part of the audit work, with the risk of not applying adequate supervision by experienced practitioners.

(xiii) Among large corporations, the recently introduced comités de directores have had a positive effect on the governance of those companies and in building investor’s confidence. However, they focus primarily on issues of related-party transactions and protection of minority shareholders, and they are seldom allocated the necessary
resources to dedicate sufficient time to the oversight of the financial reporting and auditing process.

(xiv) The SVS has recently increased its capacity for enforcing financial reporting requirements. However, this capacity still needs strengthening in view of the growing sophistication and complexity of the financial reporting standards, and especially given the recommended adoption of IFRS for listed companies and other public-interest entities.

(xv) Companies are required to publish financial statements before the shareholders annual general meeting, but only in an abridged version, in the form of a balance sheet and a profit and loss statement.

(xvi) Companies are not required to invite auditors to attend the annual shareholders’ meeting, and in practice they seldom attend the annual meeting.

(xvii) Auditors are not permitted to derive more than 15% of their revenues from one client and are required to be independent of the companies they audit. Independence is defined as “not possessing, directly or indirectly, more than 3% of a company’s subscribed capital”. In most jurisdictions the law or regulations prohibit external auditors from owning any shares at all in a client company.

(xviii) Legislation on capital markets has been reinforced in 2001 and is due to be strengthened in the near future, including on financial reporting and audit aspects.

B. Recommendations

42. The main purpose of this ROSC assessment is to assist the Government of Chile in strengthening the private sector’s accounting and auditing practices and in enhancing financial transparency in the corporate sector. In turn, these activities are integral components of a broader effort to address certain of Chile’s strategic objectives including: (i) maintaining sustained levels of FDI, (ii) enhancing the investment climate, (iii) supporting the development of the SME sector, (iv) ensuring the stability of the financial sector, and (v) furthering the country’s economic integration internationally. The policy-based recommendations arising from the assessment of existing practices will be discussed during a workshop in Santiago with the Government and in-Country stakeholders; a Country Action Plan will be developed at that time identifying specific activities to be undertaken for the implementation of the ROSC recommendations, under the supervision of the Ministry of Finance (MoF)—possibly with assistance from the World Bank and other international development partners. Insofar as the recommendations would support some of the key development objectives set by the Government of Chile, a wide range of Country stakeholders, would benefit from them, including:

- The financial community, especially pension funds, investment funds and banks, since increased accuracy and reliability of the financial information could enhance their ability to make informed investments and loans, and could lead to broadening pension funds’ possibilities of investing;

- SMEs and large non-registered enterprises, who could gain easier and cheaper access to capital. Making available more complete and accurate financial statements to investors and lenders will allow them to place greater reliance on those statements, which in turn will contribute to diminishing the perceived or real risk related to these investors and lenders; ultimately, the improved perception of these enterprises should
lead to reducing the investing and lending premium on SMEs. SMEs’ financing costs could thereby be reduced and their development prospects improved;

- *Employees of the private sector*, who have an important stake in their company’s success, and are therefore entitled to receive accurate information based on which they can judge the impacts and soundness of management decisions. Also, as future retirees they would be the ultimate beneficiaries of private pension funds’ improved investments as discussed above;

- *The public sector*, since taxes on corporate profits are based on accounting records; reinforcing accounting and auditing practices in the corporate sector would support the Government’s efforts to limit tax evasion and increase its revenues;

- *The accounting profession*, as increased visibility and public confidence arising from a selective certification process would elevate the image of the profession in the minds of the broader business community and its ability to attract high quality graduates.

43. **The authorities should amend the Company Law so as to extend the auditing and public disclosure requirements currently applicable to registered companies to a wider range of enterprises.** Many developed countries, including EU members, require all public-interest entities to have their financial statements audited and to file them with a regulatory agency. In Chile, only a relatively limited number of such entities are currently subject to compulsory audits. Although the notion of “large enterprises” applied in Chile probably covers a number of entities that are still relatively small, requiring the largest, non-registered ones to have their financial audited and filed with a public registry of accounts to which third parties could access would bring several benefits to the Chilean economy. (a) Lenders and investors would have the possibility to access financial information from more companies, allowing wider and more accurate comparative analyses. They would be able to make more informed decisions, helping reduce the cost of banking intermediation or investment-making and monitoring, and the cost of capital for Chile’s large enterprises. (b) Tax authorities and other regulatory agencies would have more immediate access to financial information from a wider base of enterprises for conducting their enforcement activities. (c) The corporate sector as a whole would be more transparent financially.

44. **The authorities should adopt IFRS as the mandatory accounting standards for all public-interest entities in Chile, through an amendment of Company Law or Regulations (RSA).** The law would provide for a reasonable transition period that allows Chilean stakeholders to assess the implications of such change and to prepare adequately to meet the new requirements. This evolution would signal Chile’s continued economic integration within the international community and economic leadership within the Latin American region. Chilean accounting standards continue to converge with IFRS but, as noted earlier, several significant differences or

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36 Public-interest entities are defined as listed companies, banks, insurance companies, pension funds, and those entities bearing significant importance to a country on account of their size—as measured by the number of employees, revenues generated annually and assets owned—or nature of business or ownership (e.g., state-owned enterprises).

37 They include all enterprises with revenues of more than US$ 3 million—see paragraph 47.

38 A *White Paper on Corporate Governance in Latin America* issued in November 2003 by the OECD on the basis of a survey of a wide range of Latin American stakeholders and with the support of the World Bank. The Paper recommends that “standard-setters should with all deliberate speed bring national accounting standards into full compliance with (...) IFRS”.

Chile – ROSC Accounting & Auditing 20
omissions remain that compromise both the comparability and the accuracy of Chilean financial reporting. IFRS will provide the country’s public interest entities and stakeholders with a clear set of standards and will also enable the country’s standard-setters to benefit from the resources of the IASB and from the confidence entrusted by users in IFRS. Considering the costs associated with the translation of IFRS, the process of adopting IFRS should be conducted in coordination with other Spanish-speaking countries.

45. **During the transition period, early adoption of IFRS by large companies should be encouraged.** The Company Law or its Regulations should be amended to provide legal backing for the use of IFRS by open corporations. The Country Action Plan will provide further details on arrangements for the transition toward IFRS. In any event, the comprehensive detailed analysis currently undertaken by the SVS on differences between Chilean GAAP and IFRS, and SBIF’s corresponding study in the banking sector, would provide a useful basis for facilitating the transition (see paragraph 54).

46. **The authorities should seek to establish a Chilean Accounting Standards Board (CASB), possibly under the domain of the CCC, as the sole body officially empowered with setting accounting standards for general purpose financial reporting in the corporate sector.** While adopting IFRS would contribute significantly to streamline the standard-setting process, several steps will still have to be handled by Chilean stakeholders themselves, including: (i) reviewing and promulgating the translation of the IASB standards and related interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC);39 (ii) issuing guidelines for the proper implementation of these standards and interpretations, as well a specific interpretations as needed to facilitate the use of the standards in the national context (e.g., on taxation, labor legislation); (iii) adopting an SME accounting standards and financial reporting framework as suggested above; and (iv) ruling on specific technical issues upon request from companies, auditors, or regulators. In order to facilitate the consolidation of responsibilities towards one standard-setting body and enhance that body’s legitimacy, it is important that its membership include diverse private sector interests (companies, investors, the accounting profession) and a large representation of the public interest including regulators. The model was developed in most OECD countries or within the IASB. Considering the relatively narrow scope of its activities as described above, the CASB could simply be established by adjusting the existing governance arrangement within the CCC with respect to its Technical Committee, by extending membership to the committee to representatives of the Superintendencies (SAFP, SBIF and SVS) and the financial statement users, and by reinforcing the transparency of the process through which the Chilean accounting standards are set. A contractual arrangement between the Chilean State and the CCC and other representative professional organization could be made to establish the By-laws of the CASB. The main benefit expected from the proposed change from a committee within the profession to a public body with wider membership and representation of the public would be increased stakeholder ownership of the accounting standard-setting process and commitment to higher-quality financial information.

39 If necessary and in a limited number of instances, the text of the standards could be adapted by the CASB to eliminate some of the options offered by certain IASs and IFRSs, or to include certain additional disclosure requirements.
47. The CASB should develop simplified accounting standards and financial reporting obligations for small and medium enterprises (SMEs) based on Chilean GAAP. It is commonly acknowledged that legislation should set financial reporting requirements for SMEs commensurate with their smaller size, simpler transactions, and narrower range of stakeholders. In this context, the CASB as the new Chilean accounting standard-setter should develop a simplified financial reporting framework for SMEs—i.e., one that would require a lesser level of disclosure, would favor the historical cost measurement basis, and eliminate the most complex options provided in IFRS, especially those requiring the use of fair values. The SME model of reporting would also include standardized, simplified financial statements and notes so as to facilitate the preparation and internal use of the financial information. This initiative would support efforts by Corporación de Fomento de la Producción (CORFO, a Government agency dedicated to the development of SMEs) to introduce voluntary certifications for SMEs to help them strengthen their business processes. By improving the quality of the financial information they produce, Chile’s SMEs will gain easier access to credit and equity financing, which in turn will help boost their development and therefore Chile’s economic growth. Since this report recommends that authorities mandate the use of IFRS by all public-interest entities, Chilean GAAP, which would be used only by SMEs, should be used as the platform for developing the proposed simplified accounting standards.

48. Establish a public oversight body for statutory auditors. Auditors have distinctive responsibilities toward the users of financial statements—including shareholders, regulators, and the public in general—in ensuring the relevance and reliability of the companies’ financial statements and contributing to companies’ efforts to strengthen their internal processes for preparing them. Failure to fulfill that responsibility can have detrimental effects on those users and on capital markets or the financial sector as a whole—including weakening confidence in the companies and discouraging investment—thereby damaging private sector competitiveness. To date, Chile has had no real form of oversight of auditors, self-regulatory or otherwise. Taking into consideration the limited resources of the CCC, that body’s limited authority under the Law, and the international trend towards external regulation of statutory auditors, the appropriate approach would be to forego the establishment of a self-regulating function within the profession itself in favor of an independent, public “Audit Oversight Board”. Auditors’ oversight would entail, among others, the following mandates:

- **Qualification of statutory auditors**—The license to conduct audits of financial statements of all public interest entities (as discussed in paragraph 43) would be awarded by the Audit Oversight Board to those professionals meeting strict requirements that

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40 The current definition of an SME in Chile is an enterprise with sales of less than U.F. 100,000 (approximately US$3 million). By comparison, in the European Union, for financial reporting purposes under the 4th Directive on company law, SMEs are defined as companies which, at the balance sheet date, do not exceed the limits of two of the following three criteria: balance-sheet total of €12.5 million; net turnover: €25 million; number of employees: 250.


42 Countries that have recently introduced auditor oversight boards include: Canada, France, Ireland, the United Kingdom and the U.S. (with the Public Company Accounting Oversight Board, PCAOB, created by the Sarbanes-Oxley Act of 2002). Spain for its part had established the Instituto de Contabilidad y Auditoría de Cuentas in 1989.
would demonstrate adequate technical knowledge and professional competence—in that regard, a due process of certification similar to those followed in fellow NAFTA countries would be the best solution (see paragraph 49);

- **Setting professional standards for statutory auditors** – The oversight board should adopt ISA and develop a code of ethics in line with IFAC’s. As previously noted, adopting ISA should pose little difficulty to Chile and will permit them to leverage the efforts of international standard setters and free up resources for more country-specific matters. Here too, there would be clear benefits for the oversight board to cooperate with other Spanish-speaking countries to share the translation effort and achieve common standard at the regional level and with Spain;

- **Enforcement of auditing and ethical standards** – While clear and stringent standards are needed, active enforcement is also a condition to ensure that the audit practice can effectively provide the expected level of assurance on the financial statements’ accuracy and truthfulness. The Audit Oversight Board should therefore monitor practicing auditors through on-site inspections to ensure that these auditors have set-up quality assurance arrangements and effectively apply ISA and the Code of Ethics. Disciplinary proceedings should be conducted for identified cases of non-compliance;

- **Reporting to the public** – The activities and findings of oversight board, as well as sanctions taken against errant auditors, should be made public. This would increase the visibility and recognition of the audit profession in the country and thus contribute to strengthening the confidence in audited financial information on the part of users on both a domestic and an international level. Publishing an annual report that evaluates the performance and progress of the auditing profession can also contribute to the stronger image of the profession.

To preserve its independence, the Audit Oversight Board should be established by an act of law; the law should set a process by which Board members would be appointed. In that regard, a majority of members should be non-practitioners in the field of accounting and auditing, such as representatives of relevant Government agencies (Superintendencies, internal revenue services, etc.), independent directors, university professors, and reputed professionals in other fields (law, finance, etc.), as well as representatives of the civil society. Adequate coordination with the Superintendencies, especially the SVS, would also be an important component of the effectiveness of the oversight process.  

49. **The authorities should support the CCC’s initiative to establish a certification process for public accountants consistent with IFAC standards, by recognizing it as the basis for licensing statutory auditors.** As noted before, the CCC is considering introducing a certification process for public accountants, including for those who would conduct external audits. The certification process would include a professional examination and the demonstration of sufficient experience in the accounting practice, consistent with internationally observed best practices and IFAC recommendations. Also, a pre-requisite to the examination to obtain the license of auditor should be a university degree of contador-auditor (or university degrees with equivalent business, accounting, and auditing contents) from a recognised university with a

43 Chilean authorities have indicated to the ROSC team that in their view the oversight of the audit profession could be exercised by the SVS instead of a separate, ad hoc institution. This alternative may be acceptable if it ensures adequate involvement of, and endorsement by, other regulatory agencies including SBIF and SAFP.
program of study certified by the Board, either directly or through some other certification agency. Also, auditors seeking renewal of their license should be required to demonstrate that they have updated their knowledge of accounting and auditing standards.

50. **Strengthen the role of the comité de directores.** Currently, directors’ committees are constrained financially and practically in the extent that they can play a proactive role in their oversight of the financial reporting process. The ROSC team endorses proposals for requiring directors’ committees to report annually to the shareholders on their activities and conclusions. Furthermore, in order to ensure that directors’ committees have adequate means to execute their oversight of the financial reporting process effectively, they should have unrestricted access to the auditors and company personnel. In addition, they should have specific financial resources to carry out investigations in accounting, legal and other fields. To that effect, the authorities should consider amending the Company Law to give them the possibility to submit their annual budget to the Board of Directors; should the Board consider such budget excessive, it would need to refer the issue to the shareholders. This step toward enhancing the effective role of the directors’ committee in the financial reporting process would help the furthering financial transparency among Chile’s largest companies, which is a key element of the local stock market attractiveness vis-à-vis domestic and foreign investors.

51. **Increase regulatory agencies’ enforcement capacity with respect to financial reporting, especially SVS’.** Regulators should have the resources to perform in-depth analysis of corporate financial statements, conduct on-site inspections of companies, and reviews of auditors. The staff of regulatory agencies will also need to receive training so that they would be in a position to effectively enforce compliance with IFRS in the future.

52. **Strengthen academic curricula in the field of accounting and auditing, as well as professional education and training.** In order for future practitioners – especially would-be auditors – to have a sufficient academic background in the field of accounting and auditing, the university curricula leading to the degree of contador-auditor should be harmonized at a national level. In that regard, the Government agencies involved in the accreditation of university degrees should establish guidelines consistent with IFAC’s recently issued International Education Standards for Professional Accountants (IES). Furthermore, professional accountants should be required to follow training programs to improve and update their knowledge of international standards and best practices in the field of accounting and auditing.

53. **Company Regulations should be amended to prohibit auditors from owning any shares in a company whose financial statements they audit.** The current 3% threshold for allowing such shareholding can have effects adverse to auditor independence, and is not in line with the stricter prohibition prevailing in most OECD countries. It should therefore be eliminated.44

54. **Company Law should require that statutory auditors be invited to attend annual shareholders’ meetings in all public interest entities.** The auditors should be available to formally answer questions from any shareholder on the financial statements. This would serve to

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44 Based on discussions with Chilean authorities, there is a concern that the prohibition from holding any shares in an audit client within an auditing firm, if extended to all employees, may be too strict and inadequate in the Chilean environment. The authorities should assess whether the prohibition could apply only to persons with management positions in audit firms (e.g., partners), or only to members of the particular audit engagement team. To that effect, it would be useful to refer to IFAC’s Code of Ethics for Professional Accountants for guidance.
further legitimate and strengthen the role the external audit plays in the corporate governance system. In turn, it would contribute to reinforcing minority shareholders’ ability to voice any concern and seek clarification regarding the financial reporting, and would improve investors’ confidence in the country’s corporate system.

55. The authorities should consider requiring audited, unabridged financial statements of all public interest entities to be made available to the shareholders prior to the annual general meeting, either through the internet or by having those companies providing copies of the financial statements free of charge. Some Chilean registered companies publish their FECUs in the press, but many include only publish the abridged version as required by the law (i.e., balance sheet and income statements). Those abridged financial statements are not sufficient to allow a proper review by the shareholders because they lack sufficient details necessary to the analysis and understanding of the company’s financial position, performance and cash-flows. In order to be in a position to properly review the financial statements submitted to their approval and make an informed decision about the financial statements, the shareholders should be able to obtain the financial statements through the internet or to obtain upon request a copy of the complete, unabridged version (i.e., in the full FECU format).

56. Various recommendations of this ROSC, including adopting IFRS, setting-up a mechanism for all public interest to file their annual financial statements and establishing the Chilean Accounting Standards Board (CASB) and Audit Oversight Board (AOB), may require technical assistance. As previously indicated, the Country Action Plan will identify key activities—including designing processes and organizational structures, drafting new legislation or regulation, and dealing with issues of human resources—that would support the implementation of the ROSC recommendations and the related technical assistance, which could cover the following areas:

- Adoption of IFRS for all public-interest entities — As discussed in paragraph 44, adopting IFRS is expected to bring major, long-lasting benefits to Chile’s economy. Nonetheless, switching from national GAAP will represent a major undertaking, as demonstrated by the case of EU countries. It will therefore need a high level of preparation by all Chilean stakeholders. In that perspective, analyzing cases of other countries, especially OECD members, that have begun the process of adopting IFRS, would be extremely helpful for Chile—the examples of Australia or New Zealand, which are handling this process on their own and whose financial reporting practices are in high standing internationally, could be particularly relevant in that respect. Monitoring the transition form one set of standards to another will be an important aspect for anticipating the financial impacts of all significant differences between Chilean GAAP and IFRS, and how to apply the provisions of IFRS 1, First-time Adoption of International Financial Reporting Standards.

- Setting-up a mechanism for non-registered public-interest enterprises’ to file their annual financial statements — Here too, other countries (including Belgium, France, the United Kingdom) have implemented this type of mechanism, and technical assistance could serve to analyze those examples and identify the most adequate reference for Chile, subject to adaptations taking account of local legislation and practices. As regards the entity with which the accounts would be filed, its functions and processes would also have to be defined, including how the public would have access to the financial statements, as well as its relationship and links with other bodies and administration (e.g., statistics department, regulatory agencies, etc).
• **Establishing the Chilean Accounting Standards Board (CASB) and the Audit Oversight Board (AOB)** – The first step in creating each two bodies should be defining the By-laws or terms of reference under which it would operate. These would include: the structure of membership and identifying founding members; the procedures for selecting and appointing members; the process for reviewing and approving proposed translations of international standards (IFRS and ISA); and cooperative arrangements with other boards, especially the U.S. and European counterparts for the AOB. Also for the AOB, auditor licensing mechanisms, quality control requirements, the conduct of inspections of audit firms and individual auditors and the communication and resolution of findings arising from inspections would have to be defined. Technical assistance will help not only design those processes but address the corresponding recruitment, preparation and training efforts for the permanent staffs. The content, cost, and funding of this technical assistance, as well as the recurring budget of the two Boards, will be dealt with in the Country Action Plan.