

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Uruguay

ACCOUNTING AND AUDITING

January 30, 2006

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Executive Summary

1. This report provides an assessment of accounting, financial reporting and auditing practices within Uruguay's corporate sector, using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks, and drawing on international experience and good practices in those fields. The main objective of this ROSC is to assist the Authorities in strengthening accounting and auditing practices and in enhancing financial transparency in the corporate sector. These efforts support the following development objectives: (a) making Uruguay's business climate more attractive for foreign direct investment and foster capital market development; (b) enhancing opportunities for greater economic integration with *Mercosur*, the US and the EU; and (c) improving state-owned enterprise (SOE) governance and accountability.

2. Uruguay is one of the Latin American countries' with highest social indicators. The state-owned corporate sector includes the country's largest enterprises, banks and insurance company and represents a very significant share of the economy. The banking sector experienced a severe liquidity crisis in early 2002 and is still recovering from that crisis. The securities market is at an incipient stage with a dozen or so of bonds traded and very modest levels of trading. The principal findings of the ROSC Accounting & Auditing for Uruguay follow:

3. Uruguay's statutes on accounting and auditing are based on a framework that was developed a relatively long time ago and met the needs of Uruguay at the time. Because the statutory framework was adequate, there was no need to make comprehensive adjustments to address changing circumstances in the country. As a result, the authorities and the accounting profession followed a piecemeal approach to improving accounting and auditing regulations and practices, creating duplication in certain areas and leaving gaps in others. Uruguay's strategic objective of greater economic integration would benefit from an alignment of its standards and practices with those observed in the US or the EU, making modernization of its accounting and auditing framework all the more important.

This report was prepared by a World Bank team (LCSFM) on the basis of the findings from a diagnostic review carried out in Montevideo in September and November 2005. The task team was led by Henri Fortin who was assisted by Orlando Ferreira and Joanne Givens. Jamil Sopher provided assistance with regards to quality review. The task team also received the support of the World Bank Country Management Unit (LCC7C) in Buenos Aires, Montevideo and Washington. The review was conducted through a participatory process involving various stakeholders and led by the Government of Uruguay. The ROSC assessment was cleared for publication by the Government on January 15, 2007.

4. In 2004, Uruguay adopted IFRS in its existing version at the time (except for the requirement to present comparative information), which contributed to consolidating the country's accounting framework and was thus a very positive decision. In addition, efforts to strengthen the technical capacity of local accountants are being pursued with the technical assistance project co-funded by the Multilateral Investment Fund in cooperation with the accounting profession.
5. Since 2004, however, IFRS have been thoroughly modified to meet the needs of the international community. In view of Uruguay's strategic objective of greater economic integration within Mercosur and on a worldwide level, the best solution would be continue on the path of convergence with global standards and adopt the most recent version of IFRS.
6. In addition, even though IFRS was adopted, different rules still apply to a variety of enterprises depending on their sector or legal form. While this is an issue of lesser importance, further consolidation in the legal framework would benefit the business climate and could also help reduce the cost of doing business in the country.
7. State-owned enterprises (SOEs) play a major role in Uruguay's economy. They are governed by specific provisions of the Constitution, laws and regulations. SOEs are audited by the public sector auditor (Court of Accounts) and, most of the times, by a private audit firm, on a voluntary basis. The review of the IFRS 2003-based financial statements of the four largest SOEs (for 2004) found that the presentation of these financial statements was good, although in one case the auditors reported a number of issues that put in question the reliability of the information presented.
8. The securities market is still at an incipient stage, with a very small market capitalization (\$100 million) and less than a dozen bonds traded on the two stock exchanges of Montevideo. The main challenge the exchanges face at the moment to develop listings and trading levels is a lack of investor confidence. The supervision of listed companies is a shared responsibility of the National Audit Office (AIN) and the Central Bank (BCU). This arrangement is not optimal and weakens the enforcement regime.
9. Non-listed companies are not legally required to have audited financial statements. However, BCU regulations require banks to obtain such audited statements from their larger corporate borrowers, regardless of whether they are non-listed. A recent significant development is the Tax Administration's requirement that mid-sized taxpayers submit financial statements with their annual tax return, accompanied by a limited review report and that 230-odd large taxpayers submit audited financial statements. Although this measure is too recent for its effects to be assessed, it is expected to have a positive impact on local accounting practices.
10. Uruguay is one of few countries in Latin America to require non-listed companies to file their financial statements with an official registry accessible to the public. Smaller companies are exempt from this obligation. In the financial sector, banks and pension funds are required to publish their audited financial statements; for insurance companies, only balance sheets and income statements are published, without the audit report.
11. Listed companies are required by law to appoint a *síndico*, with wide ranging oversight functions that overlap with the work of external auditors, including the issuance of an opinion on the financial statements. The role of *síndicos* is unclear and their added value to the oversight of the financial reporting process is often seen as limited.

12. The Uruguayan accounting profession has garnered a good reputation both locally and throughout Latin America. The professional body, CCEA (*Colegio*), which is the oldest accounting association on the continent, has had a prominent role setting standards for accounting, and even more so for auditing.

13. Accounting education is a strong tradition in Uruguayan universities. However, licensing requirements are not at par with international best practices as codified by IFAC, which include professional examination, professional experience and, after the license is initially awarded, continuing professional development.

14. Notwithstanding the adoption of IFRS, Uruguay's drive toward stronger integration in the world economy poses several challenges to the profession. One is building its technical capacity so as to cope with IFRS and the demand for higher quality corporate financial information, which in turn will enable banks to monitor credit risk more effectively and create conditions favorable to attracting foreign investment. Another challenge is strengthening the audit practice through enforcement actions and an enhanced professional licensing process, comparable to international benchmarks. The absence of mandatory affiliation to CCEA is perceived by the profession as a significant drawback in achieving those goals. Nonetheless, the profession's strong image should provide a sufficient incentive for its members to commit to a higher level of professional standard as this will not only protect its image but also could enhance it on an international level. The CCEA has received the financial support of the Multilateral Investment Fund to help it address some of its current challenges, including enhancing the ability of its membership to use IFRS.

15. CCEA's ethical standards were issued in 1944, which shows that the profession attached importance early on to professional conduct. Sixty years later, there is a need to update the standards with current conditions.

16. General-purpose accounting standards are set in Uruguay through Presidential Decrees. The decrees are drafted by a commission (CPNCA) headed by the AIN. The CPNCA has neither adequate resources nor clear and sufficiently detailed terms of reference. Addressing these issues and thereby enhancing CNPCA's role as a standard-setter is necessary if Uruguay is to keep abreast of the most current version of IFRS.

17. The Central Bank (BCU), which regulates the whole financial sector, including the stock market, plays an important role in the field of accounting and auditing in Uruguay. In the absence of a professional licensing system, BCU had established a registry of external auditors whose members are often considered an elite within the profession. BCU mandates the use of ISA. Even though auditing is a critical process for Uruguay's financial sector, other in-country stakeholders besides the BCU (including CCEA and the stock markets) should play an active role in regulating the audit profession in the country.

18. Accounting standards for financial reporting by banks and insurance are set by the BCU for both prudential and general-purpose reporting. These standards differ substantially from IFRS; the BCU is considering eliminating them in the medium term.

19. Listed companies must publish both their legal-entity and consolidated financial statements, but only the legal-entity statements are audited. Consolidation is not required from SOEs, banks, insurance companies or non-listed enterprises.

20. Except in the financial sector, there is no legal definition of an audit of financial statements, in terms of objectives, content and form of reporting. The CCEA which is a *de facto* standard-setter for non-listed enterprises has adopted a prior version of ISA which omits several

significant new standards released by the International Auditing and Assurance Standards Board (IAASB) in 2004 and 2005.

The recommendations of this ROSC are summarized in the attached table.

SUMMARY OF RECOMMENDATIONS					
Action	Type (see footnote)	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
1. Adopt IFRS as the single set of standards for all enterprises, including the SME version once available	1* and 2	CPNCA			x
1. a. Amend existing decrees to replace IFRS 2003 with IFRS 2005 as the accounting standard for Uruguay	2	MEF, CNPCA	x		
2. Adopt the most current version of ISA and IFAC's code of ethics	2 and 3	MEF, in consultation with CCEA	x		
3. Implement BCU's project to harmonize regulatory accounting principles for banks with IFRS	2 and 3	BCU		x	
4. Mandate IFRS for general purpose financial reporting by insurance companies, once the IASB's <i>Insurance Contrats</i> – Phase II is completed	2 and 3	BCU			x
5. Grant administrative autonomy to the CPNCA and increase its resources by allowing member charges	1* and 3	MEF		x	
6. Strengthen the enforcement of listed companies' financial reporting obligations, by enhancing coordination between AIN and BCU and possibly by combining their enforcement functions insofar as they relate to listed companies	1 and 3	MEF, BCU		x	
7. Require that all large to medium-sized companies file their audited financial statements with the AIN registry (REC) and make the statements accessible online. Eliminate the obligation to publish financial statements in gazettes and newspapers	1* and 2	MEF, AIN		x	

- 1: Recommendations entailing new legislation or amending existing laws [*: These recommendations can be addressed collectively through one legislative action]
- 2: Recommendations involving changes in the regulations (decrees, etc.)
- 3: Actions aimed at strengthening the institutional and technical capacity of stakeholders (regulators, auditors, etc.)

SUMMARY OF RECOMMENDATIONS (CONTINUED)

Action	Type (see footnote)	Responsibility	Timing of effective implementation		
			Short-term (within 1 year)	Medium-term (1 to 2 years)	Long-term (2 to 4 years)
8. Introduce a certification process for accountants, which could serve as the basis for the registration of all statutory auditors	1 and 3	CCEA, in conjunction with MEF and BCU			x
9. Establish a system of independent oversight for all statutory audits involving BCU, CCEA, AIN and other key stakeholders	1 and 2	AIN, BCU, CCEA			x
10. Amend Company Law to include the explicit requirement that consolidated financial statements, when applicable, be audited	1*	MEF		x	
11. Improve SOEs' financial reporting including by (a) strengthening the TCR's audits of SOE financial statements and (b) reaching an agreement with all major SOEs to the effect that they publish their financial statements and have these audited by private accounting firms	3	MEF, in conjunction with TCR and SOEs	x		
12. Require all public interest entities to publish audit reports along with their financial statements, including (a) SOEs and (b) insurance companies	2	(a) MEF (b) BCU	x		
13. Mandate partner rotation within audit firms for all audits of public interest entities	2	BCU, CCEA		x	
14. Clarify the function of <i>síndico / comisión fiscal</i> , eliminating any redundancy with external auditors	1*	MEF			x
15. Update academic curricula in the field of accounting and auditing with IFAC's education standards	2 and 3	Universities and CCEA		x	

- 1: Recommendations entailing new legislation or amending existing laws [*: These recommendations can be addressed collectively through one legislative action]
- 2: Recommendations involving changes in the regulations (decrees, etc.)
- 3: Actions aimed at strengthening the institutional and technical capacity of stakeholders (regulators, auditors, etc.)

CURRENCY: URUGUAYAN PESO
1 US\$ = 23.7 UYU as of December 31, 2005

MAIN ABBREVIATIONS AND ACRONYMS

AFAP	pension fund administrator
AIN	National Audit Office (<i>Auditoría Interna de la Nación</i>)
BCU	Central Bank
BEVSA	<i>Bolsa Electronica de Valores</i> (stock exchange)
BHU	Mortgage Bank
BROU	Republic Bank (<i>Banco de la República Oriental del Uruguay</i>)
BSE	State Insurance Company (<i>Banco de Seguros del Estado</i>)
BVM	<i>Bolsa de Valores de Montevideo</i> (stock exchange)
CCEA	College of Accountants, Economists and Business Administrators of Uruguay
CPD	continuing professional development
CPNCA	Permanent Commission on Accounting Standards
DMVCA	Securities Market and Pension Fund Supervision Division of the BCU
FDI	foreign direct investment
FSAP	Financial Sector Assessment Program
GAAP	generally accepted accounting principles
GDP	gross domestic product
GoU	Government of Uruguay
IAPS	International Auditing Practice Statements
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IDB	Inter-American Development Bank
IES	International Education Standards for Professional Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
INAC	National Meat Institute (<i>Instituto Nacional de la Carne</i>)
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
LSC	Commercial Companies Law (<i>Ley de Sociedades Comerciales</i>)
MEF	Ministry of Economy and Finance
MERCOSUR	Common Market of the South
MIF	Multilateral Investment Fund
REC	Financial Statement Registry (<i>Registro de Estados Contables</i>)
ROSC	Report(s) on the Observance of Standards and Codes
SA	corporation / joint-stock company (<i>sociedad anónima</i>)
SIIF	Superintendency of Financial Institutions
SME	small and medium enterprises
SOE	state-owned enterprise
SSR	Superintendency of Insurance and Reinsurance
TCR	Court of Accounts (<i>Tribunal de Cuentas de la República</i>)
UI	<i>Unidad Indexada</i> (100 UI = US\$6 approximately)
UR	<i>Unidad Reajutable</i> (equivalent to US\$10 approximately)

I. BACKGROUND

1. The review of accounting and auditing practices in Uruguay is a part of the joint initiative by the World Bank and International Monetary Fund on Reports on the Observance of Standards and Codes (ROSC). It focuses on the strengths and weaknesses of the accounting and auditing environment in the corporate¹ sector, and how these influence the quality of corporate financial reporting. International Financial Reporting Standards (IFRS²) and International Standards on Auditing (ISA³), as well as international good practices are used as benchmarks for this assessment, which covers both statutory requirements and actual practices. A Corporate Governance ROSC was conducted in parallel by the World Bank.

2. **With a population of 3.4 million and a gross domestic product (GDP) of US\$14 billion at the end of 2004, Uruguay has some of the highest social indicators in Latin America.** This applies especially to infant mortality, life expectancy at birth, literacy and access to water. The country's main economic sector is services, accounting for 61% of GDP. Agriculture still accounts for 12% of GDP and is considered of strategic importance to the country. Following structural reforms initiated in the 1980's, hyperinflation gradually gave way to single digit inflation levels by 1998. During the same period, GDP grew at an average annual rate of 3.9% in real terms. This growth was fueled by prudent fiscal and monetary policies and a favorable external environment. However, from 1998-2002, the appreciation of the Uruguayan Peso had a negative effect on the corporate sector's competitiveness, especially after Brazil let its currency float in early 1999. This adverse effect was compounded by falling international prices for Uruguay's main exports.

3. **Over the recent period, Uruguay's economy has experienced a recovery from the 1999-2002 crisis.** Uruguay's difficulties peaked in December 2001 with the economic and political crisis that engulfed Argentina. Unemployment reached 17% in 2002 up from 10% in 1998. GDP decreased by more than 17% in real terms between 1999 and 2002. In 2004, the economy began recovering: GDP grew by 12.3%, unemployment fell to 13% and inflation dropped to 7.6% after peaking at 26% in 2002. On the fiscal side, the primary surplus rose above 4% in 2004, while the overall public sector deficit was cut by half between 2002 and 2004 to 2.2% of GDP. Moreover, Uruguay benefited from the support of the IMF, the World Bank and the Inter-American Development Bank (IDB), which committed US\$4 billion between June 2002 and February 2005.

4. **Uruguay is seeking not only to revive its economic ties with Argentina and Brazil but to further its integration in the world markets.** After the 1999-2002 crisis, the share of Uruguay's export trade with Argentina and Brazil fell from 42% in 1999 to 18% in 2004. Uruguay is a member of *Mercosur*⁴ and hosts one of its key institutions (Permanent Secretariat). One of the Government's priorities is to enhance the benefits of membership in the

¹ In this report, "corporate sector" is used to refer to all private companies (financial and non-financial) as well as state-owned business enterprises.

² IFRS correspond to (a) the pronouncements issued by the International Accounting Standards Board (IASB), termed "IFRSs", (b) International Accounting Standards ("IASs") issued by IASB's predecessor, the International Accounting Standards Committee (IASC), and c) related official interpretations (IFRIC and SIC).

³ ISA are issued by the International Auditing and Assurance Standards Board (IAASB), an independent body within the International Federation of Accountants (IFAC).

⁴ *Mercosur* stands for Common Market of the South (*Mercado Común del Sur*) which includes Argentina, Brazil, Paraguay and Uruguay. Bolivia and Chile are associate members.

Mercosur—which had a limited impact over the last decade. Initiatives advancing this goal include, *inter alia*, harmonization of business standards among member countries. Discussions are currently taking place between member country authorities for the harmonization of regulations and norms of accounting and auditing, with the hope that these, together with other measures, can help stimulate trade and cross-border investment. In addition, the government’s strategy for “*Uruguay Integrado*” seeks further diversification of its export base, beyond the *Mercosur*; in that context the country aims to develop closer economic relations with the US and the EU.

5. **The commercial banking system, which is the main provider of funding to enterprises, is still recovering from the severe liquidity crisis it suffered in 2002.** Uruguay traditionally attracted offshore bank deposits, especially from neighboring Argentina and Brazil. This provided the impetus to develop the country’s financial sector. As discussed in Box 1, Uruguay’s banking sector went through a major crisis in early 2002 and is still recovering. The insurance sector comprises 15 companies representing total annual premium income of about US\$ 267 million in 2004.⁵

Box 1 – Uruguay’s banking sector and the banking crisis of 2002

In December 2001, in the immediate aftermath of the Argentine crisis, numerous non-resident depositors in Uruguay rushed to withdraw their funds. This quickly led to the collapse of several local commercial banks, including the largest private one, *Banco Comercial*. Additionally, the country’s two large state-owned banks, Mortgage Bank (*Banco Hipotecario del Uruguay* or BHU) and Republic Bank (*Banco de la República Oriental del Uruguay* or BROU) experienced acute liquidity problems and required substantial financial support by the Central Bank of Uruguay (*Banco Central del Uruguay* or BCU). As a result of these difficulties, Uruguay’s international credit rating was downgraded below investment grade in the fall of 2002.

Shortly thereafter, Uruguay took several steps to restore financial sector stability. In August 2002, the Congress enacted a law⁶ to restructure foreign currency-denominated liabilities of BHU and BROU and created a stabilization fund to help commercial banks face massive withdrawals. Overall, the state financial support to the banking sector reached US\$2.4 billion, equivalent to 17% of 2004 GDP. Furthermore, the BCU strengthened the prudential regulations applicable to all supervised entities, especially to commercial banks. Additionally, the assets of *Banco Comercial* which had been temporarily nationalized, and those of a smaller bank (*Banco Montevideo*) were restructured and merged into the new *Nuevo Banco Comercial*; a controlling interest in the latter was sold to private investors.

Today, Uruguay’s banking sector comprises (i) 11 private banks, most of which foreign-owned, (ii) two credit unions and (iii) the two public ones (BHU and BROU), representing total assets of UYU 363.6 billion, equivalent to US\$15 billion. BHU and BROU account for 52% of this total and 51% of total deposits. A Financial Sector Assessment (FSAP) is currently under way in Uruguay to assist the Authorities in monitoring the progress of the above mentioned actions.

The crisis evidenced not only that some of the banks were highly exposed to credit risk at the time but that the reporting practices observed by some of these banks did not give sufficient warning on the accounting consequences of bad debt. The BCU has sought to address these issues by, *inter alia*, tightening prudential rules, requiring banks to set up audits committees and monitoring the external audit process within banks more closely. Strengthened accounting and auditing practices are critical to Uruguay’s banking sector continued recovery.

⁵ Source BCU.

⁶ *Ley de Fortalecimiento del Sector Financiero*.

6. **Uruguay has two stock exchanges, *Bolsa de Valores de Montevideo (BVM)* and *Bolsa Electronica de Valores (BEVSA)*, both of which still play a very marginal role in providing financing to Uruguayan enterprises.** Trading at BVM and BEVSA involves mostly fixed-income Government securities. A small number of private companies have issued commercial papers (*obligaciones comerciales*) on BVM and BEVSA (13 as of December 2005), but those show very low levels of trading. Twelve companies are officially listed, representing a market capitalization of US\$100 million; about 10 of those experience some level of trading. At present, the only potential institutional investors in Uruguay are insurance companies⁷ and the four pension funds⁸ (*administradores de fondos de pensiones* or AFAP). However, they account for very small volumes of investment on the exchanges. Investors in Uruguay currently lack confidence in the securities market mainly due to a series of defaults on commercial paper issues of the late 1990s, where the issuers filed for bankruptcy relatively shortly after the papers had been issued. The most notorious case was *Granja Moro*, which defaulted on US\$12.8 million. These failures are generally attributed by reputable observers to a variety of problems including misstated financial statements, insufficient financial disclosure and the market's lack of caution and experience in analyzing the financial statements and other financial information at the time. The credibility of the securities market as a whole was severely damaged as a result of these cases; and, a precondition to reviving this market is to restore investors' confidence, which appears very low at the moment. To that effect, efforts should focus on educating the market and strengthening corporate financial reporting.

7. **State-owned enterprises (SOEs) are a very significant part of Uruguay's economy.** SOEs provide most essential services such as electricity (which is generated and distributed by UTE), water and sanitation services (provided by OSE), oil and gas (supplied by ANCAP and its subsidiary DUCSA), and telecommunications (a *de facto* State monopoly through ANTEL). As previously noted, the financial sector is dominated by the two state-owned banks, BHU and BROU; and *Banco de Seguros del Estado* (BSE) enjoys a quasi-monopoly on insurance activities. Given the dominant role of SOEs in Uruguay's economy, it is essential for Uruguay that they observe high levels of financial transparency.⁹

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

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

⁷ The Uruguayan insurance market comprises 15 companies, 11 of which are foreign owned. As of September of 2005, the sector controlled US\$1.8 billion in assets. 2005 premium revenue totaled US\$621 million. The state-owned *Banco de Seguros del Estado* (BSE) controls 74% of the sector's total assets and had a market share of 72% in 2004.

⁸ At the end of 2005, pension funds had 687,000 affiliates and US\$6.7 billion in investments. Close to 60% of these funds were held in government-issued paper. Less than 2% were invested in private securities.

⁹ Additional information on Uruguayan SOEs is provided in an Appendix to the Corporate Governance ROSC.

- ***Greater economic integration on regional and international levels*** – Perhaps most important, by observing financial practices similar to those of its principal economic partners and aligned with internationally accepted standards, Uruguay will enhance its ability to integrate its economy in regional and international markets.
- ***Improved management and increased transparency of SOEs*** – One of Uruguay’s priorities includes modernizing the state and increasing the state agencies’ operational efficiency, transparency and accountability. Strengthening SOEs financial reporting practices will contribute to these objectives.
- ***Capital market development*** – Reviving Uruguay’s securities market will require greater confidence on the part of investors; this can only be achieved if the company financial reporting regime which investors rely upon when making investment decisions can be regarded as timely and accurate. Therefore if companies adhere to strict standards of accounting and reporting, and auditors perform their role effectively, they can help foster an essential improvement in the investment climate.
- ***Reduced risks in the financial sector*** – The banking sector’s ability to assess credit risks properly depends largely on the accuracy and reliability of corporate financial reporting. Improving the quality of the financial information provided by enterprises therefore contributes to mitigating the risks of for banks and other lenders. In the current circumstances, better and timelier financial information from borrowers can ease liquidity constraints in the banking system.
- ***Better investment opportunities for privately managed pension funds*** – Increasing the quality and reliability of corporate financial reporting will create opportunities for pension fund managers to diversify their investments into private sector securities, thereby reducing the dependence of these funds on the banking sector and ensuring adequate long-term returns for the funds’ beneficiaries.

9. **In this context, the ROSC Accounting and Auditing in Uruguay seeks to support the following three strategic objectives:**

- Make the business environment more attractive for FDI and foster capital market development.***
- Enhance opportunities for greater economic integration with Mercosur, the US and the EU.***
- Improve SOE governance and accountability.***

II. INSTITUTIONAL FRAMEWORK FOR PRIVATE SECTOR ACCOUNTING AND AUDITING

A. GENERAL PROVISIONS OF THE STATUTES ON ACCOUNTING AND AUDITING¹⁰

10. **Uruguay’s statutes on accounting and auditing are based on a framework that was developed a relatively long time ago and met the needs of Uruguay at the time.** Because the statutory framework was adequate, there was no need to make comprehensive adjustments to address changing circumstances in the country. As a result, the authorities and the accounting profession followed a piecemeal approach to improving accounting and auditing regulations and practices, creating duplication in certain areas and leaving gaps in others. One of Uruguay’s

¹⁰ A summary of accounting and auditing requirements by type of business entity is provided in Table 1.

strategic goals is to align its standards and practices with those observed in the US or the EU, making modernization of its accounting and auditing framework all the more important.

11. **Uruguay’s company law requires commercial companies to report annually under generally accepted accounting principles, which have been aligned with IFRS in 2004.** Under the Commercial Companies Law (*Ley de Sociedades Comerciales* or LSC¹¹), company directors are required to present within four months after each fiscal year-end a balance sheet and an income statement prepared “in accordance with appropriate accounting standards applicable to each case.”¹² The LSC does not provide further definition of Uruguayan GAAP, which is left to the regulations (Art. 91). As discussed hereafter, Decree 162/04 modified by 222/04 issued in 2004 equates Uruguayan GAAP to the 2003 version of IFRS with some exceptions that are mostly presentational. Decree 103/91 issued February 27, 1991 set out a mandatory template of company financial statements (see Para. 35 below). Under this decree, the directors must present a report to the shareholders with all relevant explanations on the financial statements, including (a) significant changes in relation to the previous year’s financial statements, (b) exceptional items, (c) commercial relations with related parties and (d) future prospects for the business (Art. 92). Companies are free to choose their fiscal year-end.

12. **State-owned enterprises (SOEs) are subject to an accounting regime that is essentially the same as for the private sector, including the requirement to report according to the 2003 version of IFRS.** SOEs in Uruguay enjoy special privileges under the Constitution, including operational autonomy vis-à-vis the Government. They are governed by statutes specific to each entity and also fall within the scope of the laws on public sector accounting and auditing. Article 211 F) of the Constitution empowers the Court of Accounts (*Tribunal de Cuentas de la República* or TCR) with accounting standard-setting authority in relation to SOEs. In December 2002, the TCR issued Ordinance no. 81, *Preparation and Presentation of Financial Statements*, which mandates the following accounting standards (by order of priority): (i) provisions involving the presentation of financial statements that are set in the Ordinance itself; (ii) any regulations the TCR might issue in the future¹³; (iii) Decree 103/91; and (iv) “*International Accounting Standards issued by the (...) [IASB] or International Public Sector Accounting Standards (IPSAS) (...)*”. As a result of the above, in practice SOEs are to report under the 2003 version of IFRS, with the exceptions already mentioned.

13. **The accounting and financial reporting obligations of listed companies, banks, insurance companies and pension funds are set in specific statutes and in regulations issued by the Central Bank (BCU).** Key provisions follow:

- **Listed companies** follow the Securities Market Law of 1996 (no. 16749) and regulations issued by the BCU’s Securities Markets and Pension Fund Division (*División Mercado de Valores y Control de AFAPs* or DMVCA) including Circular no. 1942. Basic reporting

¹¹ Law 16060/889 promulgated of November 1, 1989. The law applies to any enterprise in which “two or more parties commit resources for an organized commercial activity with the intent to share its profits and assume its losses”. Commercial enterprises can adopt one of six forms provided in the law including *sociedad anónima* (SA) and *sociedad de responsabilidad limitada*. The LSC sets more stringent requirements on open SA (*SA abierta*), which correspond to listed companies.

¹² The exact wording of the law is as follows: “*Los estados contables deberán ser confeccionados de acuerdo a normas contables adecuadas que sean apropiadas a cada caso, de tal modo que reflejen, con claridad y razonabilidad, la situación patrimonial de la sociedad, los beneficios obtenidos o las pérdidas sufridas*” (LSC, Article 88). This report uses the expression “Uruguayan GAAP” (generally accepted accounting principles) to refer to applicable standards (“*normas adecuadas*”) under the law.

¹³ None has been issued to this date.

requirements to the securities regulator and the market include (a) audited, annual financial statements (in full) of the legal entity (i.e. the statements showing the activities of the parent company only), (b) the board of directors' report on business activities and performance during the year, and (c) when applicable, unaudited consolidated financial statements, all of which are due within four months after the end of the fiscal year-end. The fact that consolidated statements are not required to be audited is unusual and of concern, given that those statements are generally the ones that are most relevant for investors as they provide a comprehensive picture of the company's activities and financial position as a whole. Half-year financial statements must be submitted within two months with an independent auditor's limited review report.¹⁴

- **Banks and other financial institutions** are subject to the Financial Intermediation Law (no. 15.322) of 1982, as amended 1992 and 2002, and the regulations of the BCU's Superintendency of Financial Institutions (SIIF). Regulations include specific accounting rules and reporting requirements with a predominantly prudential focus, which differ from IFRS on a number of aspects (see Para. 49 and 51).
- **Insurance companies:** In addition to the general reporting requirement for any private company mentioned in Para. 10, specific requirements are set in Law no. 16246 and in the regulations of the Insurance and Reinsurance Superintendency (SSR), a unit of the BCU (further discussed in Para. 52).
- **Pension funds and fund managers (AFAPs):** Specific accounting procedures (*plan de cuentas*) are required for funds and management companies.

14. **Cooperatives and agro-companies are governed by specific statutes¹⁵ which in effect lead them to report under IFRS 2003 (with the aforementioned exceptions).** The National Audit Office (*Auditoría Interna de la Nación* or AIN, the principal institution in charge of internal control within the public sector) is legally vested with regulatory authority over both types of companies on accounting and auditing aspects.¹⁶ It is understood that the AIN has instructed these entities to observe the same standards as those set by the LSC for commercial companies.¹⁷

15. **Three other significant sectors (meatpacking, healthcare and free trade zone companies) are subject to regulatory arrangements that do not explicitly mandate the use of IFRS.** The meat-packing industry is regulated by the National Meat Institute (*Instituto Nacional de la Carne* or INAC); INAC-issued accounting norms on industry-specific issues date back to the early 1970's.¹⁸ In the healthcare sector, small entities ("cooperatives") operate under the supervision by the Ministry of Health. A decree issued in 2001 states that they should apply "generally accepted accounting standards in the country", which Uruguayan accountants

¹⁴ Moreover, listed companies are subject to the specific provisions of the LSC regarding "open" corporations (*sociedades anónimas abiertas*), which places them under the supervision of the AIN (see Para. 42).

¹⁵ Laws 16736/96, Art. 190 and 13608/69, respectively. Cooperatives and companies in the agriculture sector (*sociedades anónimas agropecuarias*) are excluded from the scope of the LSC.

¹⁶ Decree 223/98 for cooperatives and Decree 335/98 for *agropecuarias*. In the case of cooperatives, AIN only supervises large entities (i.e. those with revenues in excess of 60,000 UR (equivalent to US\$0.6 million – 1 UR = US\$10.65 in December 2005). *Unidad Reajutable* (UR) is an indexed unit of accounts normally used to adjust real estate rental values.

¹⁷ One exception regarding cooperatives has to do with a resolution issued by AIN on January 31, 2005 which requires cooperatives to present member contributions as equity instead of liabilities.

¹⁸ Decrees nos. 64/72 and 202/73.

generally interpret as the 2003 version of IFRS. Finally, two types of entities operate in Uruguay under offshore status. These are essentially tax haven corporations that can only hold foreign assets. One is the so-called *free trade zone corporation (sociedad anónima de zona franca or SAZF)* and the other is the *financial investment company (sociedad anónima financiera de inversion SAFIs)*. SAZFs are not subject to any financial reporting obligation in Uruguay but SAFIs must file audited financial statements with the tax authority which serve to calculate their annual license fee. For the latter, IFRS 2003, although not explicitly required, is generally applied by default. Even though SAZFs enjoy a “total tax exemption” status and are therefore more attractive, SAFIs, which exist since 1947, still attract investors as a result of their long track record as an investment vehicle.

16. Uruguay is one of few countries in Latin America that requires non-listed companies to file their financial statements with an official registry accessible to the public. Since 2001, all commercial companies (*sociedades comerciales*) with assets in excess of 30,000 UR (approximately US\$320,000) or revenues in excess of 100,000 UR (slightly over US\$1 million), must submit their annual financial statements to an official Financial Statement Registry (*Registro de Estados Contables* or REC), within 180 days after the fiscal year-end. The AIN is charged with operating the REC. The financial statements must be “certified” by a professional accountant (see Para.18). Any third party can obtain copies of the financial statements for the last three fiscal years from the REC, for a fee equivalent to US\$10 approximately.¹⁹ Although the requirement for non-listed companies to publish their financial statements is relatively unusual in Latin America,²⁰ and this provision involves practical difficulties, a strong consensus exists among in-country stakeholders in favor of such requirement. One concern with the current arrangement, however, has to do with the fact that several types of commercial business entities (aside from banks and insurance companies, which are subject to different requirements) are exempted from filing with the REC. In particular, exemptions are granted to sole proprietorships (*empresas unipersonales*), some of which can be economically significant.

17. Listed companies, banks, insurance companies, and pension funds are subject to separate publication requirements. Banks and insurance companies must publish their financial statements in the official gazette as well as in a newspaper with wide circulation. Additionally, the BCU publishes the financial statements of banks (in full), insurance companies (abridged, without the audit report), listed companies and pension funds (in full) on its website. Considering the wide use of internet in Uruguay, the usefulness of publishing financial statements in a gazette or in newspapers is questionable. Pension funds are also required to make their accounts (along with supporting documentation) available to the retirees and participants at their premises.

18. In the enterprise (i.e. non-financial) sector, only listed companies have the legal obligation to prepare audited financial statements.²¹ As previously noted (Para. 16), non-listed companies above a certain size must file “certified” financial statements with the AIN. Such certification can take the form of an independent audit, a limited review or a “compilation”. The

¹⁹ Decree 253 of 2001. The AIN estimates that close to 13,000 statements have been filed since 2001. At present to obtain copies of the financial statements one must go the offices of the AIN. The AIN has a project in progress to make the statement available online. The fee per set of financial statements is one *unidad reajutable* (UR), which is equivalent to about \$10.

²⁰ Countries who have introduced similar requirements include Brazil (for corporations / joint-stock companies) and Colombia. Filing of annual accounts by all private commercial companies is a very common practice in Europe.

²¹ BCU Circular no. 1789, Art. 41. Under the Securities Market Law, Art. 5, the BCU is charged with regulating financial reporting by listed companies.

latter, which appears to be by far the most frequent, does not entail any form of assurance that the financial statements are reliable or accurately portray the company's financial situation and performance. Moreover, the firm or person performing the compilation does not have to be independent, and oftentimes the compilation report is issued by an employee of the company itself.²² As evidenced by the ROSC review of financial statements (Para. 54 b), many non-listed companies, some of them ranking among the country's largest enterprises, only file "compiled" (i.e. unaudited) statements, the quality of which is uneven at best.

19. **The Financial Intermediation Law requires banks to obtain audited financial statements from their larger corporate clients.** Recognizing the importance for the banking sector to base credit decisions and loan portfolio monitoring on reliable financial information, the BCU/SIIF issued a regulation requiring all commercial banks to obtain audited financial statements from clients with total borrowings exceeding a certain level. This level is currently set at US\$1.2 million.²³ However, such audited financial statements are not available to potential users outside the banking sector. Making these statements available would allow other users, including suppliers and those investors and lenders interested in using the statements for purposes of sector analyses, to be aware of any issue reported in the auditor's report.

20. **A recent development of significance to Uruguay's accounting and auditing framework is the Tax Administration's decision to require mid-sized tax payers to submit financial statements with their annual tax returns, accompanied by a limited review report.**²⁴ At the same time, the 230-odd large corporate taxpayers (*grandes contribuyentes*) are required to file audited financial statements, which most of them are assumed to already have as a result of the requirement that banks obtain such audited statements from their large borrowers. Although this measure has been taken too recently for its consequences to be fully assessed, it raises several issues.²⁵ First, many of the mid-sized companies—which number is estimated at 9,000—do not have audited accounts at the moment and in many cases do not even prepare financial statements. As a result of the new measure, they will need to hire an auditor and dedicate significant resources to prepare financial statements under IFRS 2003 (including a comprehensive set of notes). This will considerably increase the market base for the provisions of audit services, representing new revenues for the profession. At the same time, however, it adds to the cost of doing business in Uruguay, and therefore is not conducive to private investment. Second, some of the large commercial entities that do not fall under the company law (e.g. sole proprietorships) will be affected by this resolution. Third, banks and insurance companies, which are all considered large taxpayers under the tax regulations, may need to prepare a set of financial statements under IFRS 2003, to comply with the new regulation. Fourth, even though the new

²² The only exceptions to this rule are the Complementary Pension Funds (Supervised by the DMVCA, these are voluntary, individual pension schemes set to complement the existing social security regime.) which are audited by the AIN. Health Cooperatives and SAFI's are also subject to external audits mandated by their regulatory agencies, the Minister of Health and the tax authority respectively.

²³ SIIF Regulations, Article 82. The limit is defined as 15% of the "basic equity requirement" required from all commercial banks, which is set at 130 million *unidades indexadas* (UI). *Unidad Indexada* (UI), is a unit of account used for commercial transactions created by Decree 210/002, modified by Decree 356/003 and set at 1.2841 UYU by Law 17761/04. It is adjusted daily until its variation matches that of the CPI for the previous month

²⁴ Resolution 1093/2005 of the Tax Administration (*Dirección General Impositiva*), December 2005. Mid-sized taxpayers as those with assets of 6,000 UR (equivalent to US\$64,000); they are supervised by a specific division within the Tax Administration's called *Control Especial de Empresas* or CEDE. Financial statements must be prepared in accordance with Decrees 103/991, 164/04 and 222/04.

²⁵ This measure is effective as of December 31, 2005 for large taxpayers and will be effective as of June 30, 2006 for mid-sized ones.

regulation mandates that IFRS 2003 are to be used to prepare the financial statements, taxable income will still be determined according to specific accounting rules, which represents additional complexity and therefore administrative costs for the companies affected by the new measure. In addition, the Tax Administration will need to dedicate significant efforts to train its personnel in IFRS 2003 in the near future.

21. **Although they are not required to do so by the statutes, most SOEs in Uruguay hire independent professional firms to audit their financial statements.** Under Uruguay's Constitution, the body charged with the control over SOE financial management and reporting is the TCR. Its role has been traditionally focused on verifying the legal conformity of expenditures with budget appropriations made by the Congress. More recently, the TCR began conducting external audits of SOE financial statements. Although some level of coordination exists between the TCR and private auditing firms, there is much room for improving their interaction. One of the problems has to do with the timing of TCR's audits, which are usually finalized much later.

22. **In the absence of a professional certification mechanism for auditors, the BCU has established its own registration process, which is useful but needs strengthening.** Each of the three supervisory units within BCU (SIIS, SSR and DMVCA) sets its own requirements regarding external audits under its purview. These requirements currently include: (a) the mandatory use of ISA as the auditing standards, (b) a contractual commitment by the auditor vis-à-vis the regulated entity (bank, insurance company, etc.) to give the supervisor access to their working papers upon request and (c) the form and content of the auditor's reports. The BCU is also considering introducing mandatory rotation (for sole practitioners and audit partners, not for firms) as a means to ensure auditor independence. In addition, since February 2001, the BCU requires all auditors, including sole practitioners and audit firms (and their partners and managers) conducting statutory audits in any of its regulated entities to be registered on its Registry of External Auditors. The conditions for registration are (a) possessing a university degree of public accountant (*contador público*); (b) being independent; (c) having an in-house quality assurance system in place and professional training programs for management and staff; (d) having a minimum level of professional experience and; (e) for banking, insurance, AFAP and investment funds only, specific knowledge of those businesses.²⁶ The registry is supervised by a committee within BCU composed of representatives from all regulatory agencies. Although the registry is intended only for qualifying auditors in the financial sector and the stock market, it is often used by other institutions (e.g., Health Ministry and Municipality of Montevideo) as a basis for selecting auditors. All of the above underscores the need to strengthen licensing mechanisms for practicing auditors in Uruguay at the level of the accounting profession as a whole.

23. **The Company Law (LSC) provides for an additional control mechanism over accounting and financial reporting among joint-stock companies (SAs).** This function, which is mandatory only for listed corporations, is given, either to one or more officers with the title of *síndicos* or to a committee of three or more members called *comisión fiscal*. The law sets for these officers a broad range of responsibilities, including the examination and issue of an opinion on the annual statutory financial statements. Síndicos can convene extraordinary shareholder's meetings and must attend board of Director's meetings regularly under penalty of suspension. They are mandated to inform minority shareholders and must investigate allegations of wrongdoing presented in writing by any shareholder. Uruguayan practitioners and regulators interviewed expressed that the effectiveness of this internal control arrangement is uneven at best. There are no minimum professional qualifications required to be appointed to these positions. In

²⁶ BCU Circular 1733 issued February 2, 2001. This regulation also includes sanctions that range from a written reprimand to permanent removal from the registry.

practice, *síndicos* and *comisiones fiscales* are responsible for overseeing the company's internal controls and must issue an opinion on the financial statements, functions which are a mix between those assigned to audit committees and external auditors. Moreover, *síndicos* usually rely heavily on the external auditor's report to issue their own judgment, making the position redundant. The DMVCA is analyzing regulatory reforms to strengthen the role of *síndicos* and *comisiones fiscales*, for instance by giving them the power to appoint external auditors.

24. **Based on the above, Uruguay's statutory framework for accounting and auditing is fairly complex and fragmented.** An overview of key provisions of the statutes is provided in Table 1.

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

Type of Entity	Regulatory Agency	Accounting Standards	Audit Requirement	Publication and Other
Bank	BCU/SIIF ⁱ	BCU/SIIF regulations (and Ordinance 81 if state-owned)	Yes, by BCU-registered auditor	Publication on BCU's website and in gazette / newspaper – Audit committee
Insurance Company	BCU/SSR ⁱ	BCU/SSR regulations (and Ordinance 81 if state-owned)	Yes, by BCU-registered auditor	Balance sheet and income statement on BCU's website and newspaper
Listed Company	AIN and BCU/DMVCA	IFRS 2003 with exceptions (IFRS 1, IAS 1 and IAS 7)	Yes, by BCU-registered auditor. ISA mandatory	Publication on BCU's website
Pension Fund	BCU/DMVCA	BCU/DMVCA Regulations	Yes, by BCU-registered auditor. ISA mandatory	Publication on BCU's website
State-Owned Enterprise	<i>Tribunal de Cuentas</i> (TCR)	IFRS 2003 with exceptions (IFRS 1, IAS 1 and IAS 7)	Mandatory audit by the TCR. Most SOEs also audited by audit firms.	Publication (without the audit report)
Non-Listed Company	n/a ⁱⁱ	IFRS 2003 with exceptions (IFRS 1, IAS 1 and IAS 7)	"Certification" i.e. audit, review or compilation (at the company's choice) ⁱⁱⁱ	Filing with AIN by large companies ^{iv} – Copies available to the public for a fee

ⁱ State-owned entities also subject to audits by the *Tribunal de Cuentas* (TCR).

ⁱⁱ Cooperatives and agro-companies are placed under the supervision of the AIN.

ⁱⁱⁱ Banks are also required to obtain audited statements from their largest clients.

^{iv} All commercial companies (*sociedades comerciales*) with assets in excess of 30 000 UR (equivalent to US\$0.3 million) or revenues in excess of 100 000 UR (equivalent to US\$1 million). Note: cooperatives, meat-packing industry, healthcare and other types of entities are subject to specific statutes.

25. **Overall, the statutory framework for accounting and auditing lacks coherence, which represents an additional administrative burden not only for the private sector but for the State itself.** As shown above, different accounting and financial reporting regimes apply for banks, insurance companies, pension funds, SOEs, listed companies, meatpacking companies, cooperatives, agro-companies, offshore, other non-listed companies. Several forms of external control over the financial statements are required on listed companies, including independent audits, examination by the *síndico o comisión fiscal* and audit by the AIN, representing duplicate

efforts. Moreover, three different sources of regulation require audits from the same companies: the company law (LSC), the tax regulations and the financial sector regulations. Such duplicate and at times conflicting requirements entail additional efforts on the part of the companies concerned and add to the cost of doing business in Uruguay, without any clear benefit.

26. **Furthermore, the fact that, in several aspects, the statutes do not distinguish between public interest entities²⁷ and other enterprises is of concern.** Contrary to the situation observed in jurisdictions such as the US, EU countries, Brazil, Mexico or Chile, listed companies in Uruguay are not subject to additional requirements regarding the form and content of their statutory financial reporting, such as a standardized *Management's Discussion and Analysis of Results of Operations and Financial Condition* required by the US Securities and Exchange Commission. Except for very small entities, non-listed companies all have the same obligations regarding external control over their financial reporting irrespective of their size. The fact that public interest entities should be subject to a stricter accounting and auditing regime than small and medium enterprises (SMEs) is widely recognized on an international level nowadays.

B. THE ACCOUNTING PROFESSION

27. **The main representative body for the accounting profession in Uruguay is the College of Accountants, Economists and Business Administrators (*Colegio de Contadores Economistas y Administradores del Uruguay* or CCEA).** The CCEA, a member of IFAC, was established in 1893 and currently has 4,855 members, representing approximately half of the total number of practicing accountants in Uruguay. In addition to playing a prominent role in the field of accounting research and professional education, the CCEA is actively involved in various issues of interest for the audit practice including the accounting and auditing standard-setting process. The CCEA is part of the Permanent Commission on Accounting Standards (*Comisión Permanente de Normas Contables Adecuadas* or CPNCA—see Para. 36 below), an advisory council for the adoption of international accounting and auditing standards. The CCEA has garnered a good reputation in Uruguay and also in the rest of Latin America for its dedication to the advancement of the accounting profession. The title of *Contador* (abbreviated “Cr”) is widely used in correspondence, press articles, etc., and even by business persons who have a degree in accounting but whose jobs may have no connection with finance or accounting. Moreover, a relatively large number of books on accounting are published in Uruguay. This is further evidence of the clout that the local profession enjoys in the country. The CCEA derives its revenues from annual membership fees (approximately US\$65) and an intensive program of seminars and training courses.

²⁷ This notion is recognized by the EU legislation and international organizations including the IASB. Public interest entities are companies that:

- (a) receive funds from the public in a fiduciary capacity, including banks, savings and loan institutions, investment funds, pension funds, and insurance companies;
- (b) provide essential public services and subject to public procurement;
- (c) are active in strategic sectors in the economy, such as defense and those who operate as monopolies;
- (d) are owned by the state (i.e. SOEs);
- (e) are economically significant to the country as a whole (often defined as other than SMEs). Criteria to determine which companies are economically significant include: total revenues, the number of employees, the amount of assets; or
- (f) have issued or have taken legal steps to issue securities on an exchange, or have a large number of shareholders representing a substantial ownership interest.

28. **Since 2004, the Multilateral Investment Fund (MIF)²⁸ has been providing funding to the CCEA for a technical assistance project (“Proyecto Convergencia”) to support the application of IFRS and ISA in Uruguay.** The overall objective of *Proyecto Convergencia* is to facilitate the transition towards international standards in Uruguay, by helping the CCEA identify areas that need improvement and then assisting in the design and implementation of an action plan to address weaknesses. The project spans 4 years and has four main components: (i) research and “convergence” (i.e. of local standards toward IFRS and ISA); this includes the development of a monitoring system to help the CCEA keep abreast of new developments relating to international standards; (ii) dissemination and capacity building, mainly through a series of training seminars on international standards; (iii) improving the quality of the professional practice and (iv) developing proposals to the authorities for updating Uruguay’s legal framework for accounting and auditing, especially the LSC and related decrees, so as to eliminate some of the current discrepancies with IFRS. The introduction of a certification process for accountants, similar to those existing in the US or Mexico is envisaged at a later stage. According to CCEA, so far, close to 40% of the project’s resources have been disbursed and extensive training activity has taken place. By the end of 2005, CCEA had organized 67 courses, seminars and workshops with close to 3,000 participants nationwide.

29. **The BCU keeps a registry of accountants authorized to perform audits in its respective areas of supervision.** The registry fills the void created by the absence of a formal qualification process in the accounting profession. In order for an accountant to be included in the registry he or she must have held a title of public accountant for at least five years of professional experience and provide evidence that they possess the adequate knowledge and resources to perform an audit for a given company/industry. In the financial sector, three years of experience in the respective business are required. As a result of more stringent requirements in the banking sector, the number of auditors licensed by the BCU is substantially smaller (less than thirty). Frequently, entities outside the financial sector use the BCU registry to select external auditors because the existing licensing requirements are insufficient and there is no alternate quality control mechanism. This situation points to the need for a more rigorous licensing process in the profession.

30. **CCEA’s standards of professional ethics establish the fundamental principles of conduct for its members, but they lack precision and provide no guidance for the application of such principles.** CCEA’s ethical standards were issued back in 1944. They are a fairly general text of 8 pages and 24 articles setting broad principles such compliance with the laws, honesty and accuracy. They comprise principles and standards governing relations with the society, the CCEA and peers, as well as provisions on a discipline panel (*Tribunal de Honor*) which has rarely, if ever, been active. The standards do not specifically address such critical aspects as (i) independence as part of audits and other assurance engagements; (ii) situation leading to potential conflicts of interests, and the threats and safeguards approach to these situations and (iii) issues involving accountant’s remuneration. IFAC’s *Code of Ethics for Professional Accountants* is a comprehensive document of 94 pages which was revised in June 2005 and is considered up to date with all key issues pertaining to the accounting and auditing practice worldwide. It should be adopted by CCEA, or be used by it as the basis to revise its ethical standards.

²⁸ The MIF is an autonomous fund managed by the Inter-American Development Bank (IDB)

31. **As is often the case elsewhere, the four large international accounting firms (“Big-4”) dominate the market for audit services in Uruguay, even though smaller firms have a significant presence on that market.** The large majority of listed companies, banks, pension funds, insurance companies and large foreign-owned, non-listed groups are audited by one of the Big-4 firms.²⁹ In the case of SOEs, the majority also choose to have their financial statements audited by one of the Big-4 firms (in addition to the TCR’s statutory audits). Approximately 20 mid-sized firms affiliated with second-tier international networks and sole practitioners are registered with the BCU.

C. PROFESSIONAL EDUCATION AND TRAINING

32. **Accounting education is a strong tradition in Uruguay.** The degree of public accountant in Uruguay is of graduate level (*licenciatura en contaduría pública*). Five universities, four of which are private, offer a curriculum in professional accounting. A large majority of CCEA members are graduates of the state university (*Universidad de la República*). Although the curricula are broadly consistent with IFAC-issued International Education Standards for Professional Accountants (IES), the syllabi of the courses on accounting and auditing show various inconsistencies in the topics covered (e.g. corporate governance, fraud, and independence considerations receive limited coverage) and in the terminology used (for instance, copious reference is made to IAS, whereas IFRS has been the official designation since 2001). In addition, because there is no minimum requirement in terms of course content set at national level, the title of public accountant does not necessarily reflect the same content and quality of education from one university to another.³⁰ In the field of auditing, partners of prominent audit firms teach at the universities; this facilitates the cooperation between the academic community and the profession and is inline with good international practice. The quality of university curricula would benefit from further alignment with IFAC’s education standards.

33. **Professional examination is not a requirement to become a licensed accountant.** Professional examinations are used mainly in Anglophone countries to assess would-be practitioners’ professional competence. However, it is still infrequent in Latin America, where the emphasis is placed on university education. Moreover, professional experience is not a prerequisite for obtaining an auditor license. The only requirement to apply for the license of public accountant is a college degree in accounting issued by one of the country’s universities with an accounting curriculum. Licensing requirements are not at par with international best practices as codified by IFAC in its International Education Standards for Professional Accountants (IES) issued since 2003. Under IES 6, *Assessment of Professional Capabilities and Competence*, “the professional capabilities and competence of [accounting accreditation] candidates should be formally assessed before the qualification of professional accountant is awarded”. Although the notion of professional certification for accountants was unknown in Latin America until 2000, some countries in the Region have adopted it since then, starting with Mexico (2000), and then Brazil (2001).³¹ Chile is planning to introduce similar arrangements. A certification process is considered essential to ensure that would-be auditors demonstrate sufficient technical capability, professional skills and experience to carry-out audits of adequate quality. The CCEA is aware of

²⁹ Of the 39 annual financial statements published by the BCU as of December 31, 2004 or June 30, 2005 29 (i.e. 75%) were audited by the Big-4 (KPMG: 12, Deloitte: 8, PricewaterhouseCoopers: 7, Ernst & Young: 2). The 10 remaining registered companies and financial institutions were audited by eight different firms of smaller size.

³⁰ *Universidad de la República* has not updated its accounting curriculum since 1990.

³¹ In the case of Brazil, in addition to a general exam required for all registered accountants, a specific exam is required to obtain the license to practice in the banking sector and among listed companies.

this situation and, as noted above, is considering developing a certification process. This could raise legal issues, as it could be seen as impinging on a reserved function of the universities in Uruguay.

34. **Continuing professional development (CPD) is not compulsory for licensed public accountants in Uruguay.** Universities and to some extent the CCEA itself provide graduate courses. Audit firms, mostly those belonging to international networks (Big 4), also provide in-house training to their personnel. Nevertheless, the absence of compulsory continuing education and training is contrary to good international practice and IFAC's recommendations.³² Accordingly, there is no assurance that practicing accountants and auditors have adequately updated their professional knowledge—on recently-issued accounting and auditing standards, types of business transactions and corresponding audit risks and approaches, current trends in accounting and auditing worldwide—and that these practitioners have maintained the needed capabilities to fulfill their responsibilities.

D. SETTING GENERAL-PURPOSE ACCOUNTING AND AUDITING STANDARDS

35. **Uruguay was one of the first Latin American countries to move toward adopting international accounting standards, although IFRS were only really adopted in 2004 and not in full.** A first if modest attempt to align the Uruguayan accounting practice with international standards occurred as early as 1991, at a time when very few countries paid much attention to international standards. However, the effective adoption of IFRS occurred much later; and it is still a very recent change to which Uruguayan companies, accountants and regulators have yet to fully adjust. Box 2 discusses the process by which IFRS (2003 version) have been adopted in Uruguay in further details. Two of the problematic aspects in the way Uruguay adopted IFRS 2003 are (a) the modifications to the original text, which are few but significant (see Para. 47 below), with no clear rationale for such differences; and (b) the timing of the adoption was far too optimistic, calling for additional training efforts in the near future. **Nonetheless, Uruguay's decision to adopt IFRS was a very important and positive step toward improving the quality of financial reporting and establishing the level of investor confidence required to foster investment activities in the country.**

36. **The Permanent Commission on Accounting Standards (CPNCA) assists the Government in drafting decrees dealing with accounting, but the standard-setting process lacks a clear definition and adequate resources.** The CPNCA was established through Resolution 90/991 of the Executive Power issued February 28, 1991. While being "permanent", the CPNCA has no specific resources, does not have terms of reference defining the process by which standards are to be developed or adopted, and it does not operate under a regular working schedule. The main benefit associated with an adequately resourced, specialized body with administrative autonomy is that it can rely on its resources and not just on voluntary, *pro bono* contributions by stakeholder groups, to conduct its standard-setting activities. Indeed the CPNCA currently lacks resources to develop application guidance and dissemination material regarding IFRS, which is part of its mandate.³³

³² Under IES 7, *Continuing Professional Development: A Program of Lifelong Learning and Continuing Development of Professional Competence*, all organizations belonging to IFAC are expected to mandate CPD for all their members.

³³ In most industrialized nations, accounting standards are issued by a specialized, autonomous body, rather than by the Government itself. In Latin America, autonomous standard-setting bodies exist in several countries including El Salvador, Mexico and Peru.

37. **The CPNCA has a wide representation of relevant authorities and stakeholder groups but BCU is notably absent.** The CPNCA is composed of one representative from (a) the AIN (permanent chair), (b) Ministry of Economy and Finance (MEF), (c) CCEA, (d) State University's School of Economics and Business Administration, (e) Chamber of Industry, (f) Chamber of Commerce, (g) Montevideo Stock Exchange (BVM), (h) Bar Association, and (i) Association of Notaries (*escribanos*). Considering that the BCU is the regulator for the financial sector as a whole and banks are the main users of corporate financial statements at present, it would make sense to include at least one representative from this key institution in the membership of the CNPCA. Moreover, financial statement users are under-represented, especially commercial banks, insurance companies and pension funds.³⁴ Finally, in the case of the academic community, one institution is granted the privilege to appoint a representative at the CPNCA, whereas there are other institutions which could legitimately be associated. This is also the case for the stock market, where there are two exchanges (BEVSA and BVM) but only one (BVM) represented on the CNPCA.

Box 2 – Convergence of Uruguay's accounting standards with IFRS

There were four major milestones in Uruguay's adoption (albeit incomplete) of IAS/IFRS. A first important step was the issuance of Presidential Decree no. 105/91 of February 27, 1991. It required the use of eight of the 27 International Accounting Standards (IASs) existing at the time, with certain modifications, which included the fact that presenting comparative information as required under IAS 1.21 was only optional,³⁵ in addition to the fact that the presentation of the financial statements defined in previously-issued Decree 103/91 differed from that prescribed by IAS 1. In May 1993, an additional five IASs were made mandatory, with some modifications as well.³⁶

In May 2004, eleven years later, a decree was passed mandating the full application of IFRS in their Spanish version prevailing at that date, for all reporting periods beginning after the date the decree was passed (i.e., in practice, for fiscal years ended June 30, 2005 or December 31, 2005, depending on the closing dates used by companies). In effect, 23 IAS/IFRS standards were adopted along with changes to eight previously adopted standards.³⁷ The list of IAS/IFRS standards including the timing for their adoption in Uruguay is provided in the Appendix.

While adopting IFRS was the best solution for Uruguay, the time given to stakeholders to prepare for such move was much too short especially when compared to the experience of other countries that also adopted IFRS. Considering the magnitude of the change introduced by Decree no. 162/04, the period between the date it was enacted (May 2004) and its effective application (as early as June 2005) was far too short to allow companies, auditors and regulators to be adequately prepared to operate under full IFRS.

³⁴ The Banking Association was originally represented but this institution has ceased to exist since then.

³⁵ The eight IASs adopted in 1991 were nos. 1, 2, 4, 5, 7, 8, 9 and 10. The full text of the standards (Spanish translation) was attached to the Decree. Other modifications to the standards consisted of the following: (a) the statement of changes in financial position (IAS 7) was only required for companies with higher accountability under local laws; and (b) miscellaneous provisions of the standards (IAS 2.26; IAS 5.9 and IAS 5.17) were made optional.

³⁶ Standards adopted as mandatory were nos. 11, 13 (except for four paragraphs treated as optional), 16, 17 and 18; IAS 12 and 14 were adopted but only as optional.

³⁷ Decree no. 162/04 issued May 12, 2004 (amended by Decree 222/04 of June 30, 2004). The Decree mentions "International Accounting Standards issued International Accounting Standards Board", although IFRS would have been a more appropriate wording. The full text of Decrees 105/91, 200/93, 162/04 and 222/04 is available at http://www.ain.gub.uy/decretos_res_inst/jurisprudencia_decretos.htm.

Indeed, the experience from the adoption of IFRS worldwide shows that the transition period should be of at least four years to allow the following preparation activities: (a) thoroughly analyzing each IAS/IFRS standard and related interpretation, to identify the main changes they will introduce and the difficulties their first application is likely to pose, and how those difficulties can be mitigated; (b) assessing the need for companies to upgrade their information technology in order to provide the information required by IFRS; (c) conducting surveys of the accounting profession to assess the state of their knowledge of IFRS and the corresponding training needs; and (d) for each company, performing “real life” testing of the application of IFRS on the prior year accounts and estimating the main impacts.

It is too early to assess the consequences of such a tight time schedule for adoption since most Uruguayan companies have December 31 as their closing date and will produce their first set of IFRS 2003-based financial statements in the first half of 2006. Nevertheless, discussions with the CCEA and leading audit firms, backed to some extent by the findings of the ROSC review of financial statements on listed companies and SOEs (Para. 54 a) and d)) does suggest that the transition has not been smooth and that additional training for accountants in the public practice and in business as well as regulators and financial analysts is needed.

38. **Training programs to be developed under MIF-funded technical assistance are expected to bring the profession’s technical capability to the level of IFRS.** Some efforts have been made since the adoption of IFRS to train accountants and stakeholders, but those efforts have been limited. Moreover, guidance material for the application of the standards is not easily accessible to practitioners. One of the components of the technical assistance project currently being co-funded by the MIF includes holding a series of technical seminars and the development of training material on IFRS.

39. **Even though Uruguay law does not define independent audit (except in the financial sector), and affiliation with the CCEA is voluntary, CCEA is the *de facto* standard-setter for auditing.** This provides further evidence of the recognition CCEA enjoys in Uruguay, no one disputes its leadership on matters of professional practice.

40. **CCEA officially endorsed ISA in 2000, but the version it adopted is significantly out-of-date in relation to current standards, leaving out important new pronouncements issued subsequently, or revisions of pre-existing standards.** Historically, Uruguay did not develop a comprehensive set of auditing standards but instead relied on external sources of standards and material provided by the academic community, the observance of which was not mandatory. In 1967, the CCEA issued Pronouncement no. 2, Auditing Standards and Procedures, a three-page document setting forth broad principles of professional conduct, auditing procedures and reporting. Then, in 1990, Pronouncement no. 9, *Generally Accepted Auditing Standards in Uruguay* endorsed 16 of the then-existing International Auditing Practice Guidelines (since then incorporated into ISA), in lieu of Pronouncement no. 2. Some modifications to the international terminology were made to reflect the language commonly used in Uruguay. More recently, in 2000, CCEA Pronouncement no. 13, also entitled *Generally Accepted Auditing Standards in Uruguay*, mandated the use of 28 ISAs and 10 International Auditing Practice Statements (IAPS), without any modification.³⁸ Considering the fact that Uruguay has a relatively long experience in using international auditing standards, and since most of the leading audit firms are already required as a result of their obligations toward the international network they are affiliated with, full adoption of ISA would be a natural next step for Uruguay.

³⁸ CCEA’s pronouncement can be accessed at <http://www.ccea.com.uy/pronunciamentos/index.asp>.

E. ENFORCEMENT OF ACCOUNTING AND AUDITING STANDARDS

41. **The BCU's supervisory arms (SIIF, SSR and DMVCA) are charged with enforcing accounting and financial reporting regulations by banks, insurance companies, pension funds and securities market participants.**³⁹ The SIIF requires detailed periodic information from banks and conducts monthly desk reviews to detect misstatements in accounting records. On the issue of compliance with accounting standards, there is a strong reliance on the work of the external auditors. SIIF also conducts on-site inspections that include auditing of information systems. All these procedures are documented in a manual of operation and carried out by a staff of 30 professionals divided in five different supervision units. The SSR and DMVCA are vested with similar responsibilities for insurance, pension funds and listed companies, with smaller staffs however. Both Superintendencies and the DMVCA have imposed sanctions for non-compliance with accounting requirements in the past against supervised institutions. These sanctions have mainly taken the form of reprimands and fines. Sanctions other than reprimands have been taken against errant auditors in two instances.

42. **The responsibility to enforce listed companies' financial reporting obligations is shared by AIN and BCU, with little coordination between the two.** The AIN is charged with monitoring the compliance of open corporations (*SA abiertas*) with their obligations under the LSC. These obligations include presenting financial statements to the shareholders at their annual general meeting. At the same time the Securities Market Law assigns the regulation and supervision of listed companies (which are the same as open companies) to the BCU (see Para.7). Therefore, the confidence that investors can place in the financial information they are provided depends to a large extent on the auditor's reputation. It should be noted that AIN also has significant responsibilities in the public sector where it leads the internal control system. The appropriateness of combining private sector enforcement functions and public sector audit functions under the same should be addressed in the medium to long term.

43. **Financial reporting by non-listed (private) enterprises is not subject to any regulatory supervision.** In several countries of Latin America, including Colombia, Ecuador and El Salvador, regulatory agencies are charged with enforcing accounting and financial reporting by non-listed companies. In practice, such a function is difficult to carry out given the large number of supervised entities and the limited resources government can normally allocate to these agencies. The most effective means to ensure that non-listed companies—especially those that have public interest characteristics due to their size or the nature of their activities—comply with their obligations to provide accurate financial information under a specified set of accounting principles is to require an independent audit. Ensuring the reliability of company financial statements is all the more important as these are made available to the public through the REC and used by third parties for business decisions.

44. **CCEA does not enforce professional standards among its membership.** The fact that affiliation with the CCEA is voluntary limits its ability to enforce ethical conduct or even the application of its standards by its members. As a result, compliance with of ISA and CCEA's and IFAC's codes of ethics⁴⁰ is only achieved through the internal procedures of the audit firms themselves, mainly the international ones. Nonetheless, internal quality control procedures within international audit firms are governed by confidential agreements and are not transparent. Accordingly, they cannot be considered sufficient to provide in and by themselves a quality

³⁹ Law on BCU (*Carta Orgánica del BCU*), Art. 38 and 41.

⁴⁰ Applying ISA implies abiding by IFAC's code of ethics (per ISA 200, Paragraph 4).

assurance system within the accounting and audit profession in a given country. The BCU registry does set some ground rules for conducting statutory audits in the financial sector but enforcement seems to be weak. For example, independence of auditors is established as a requisite for registration, but the concept is not clearly defined, and therefore difficult to apply in the selection process.

45. **Overall, enforcement of accounting and auditing standards is quite limited outside the banking, insurance sector and pension funds and securities market participants, which limits the impact for Uruguay's having adopted IFRS 2003.** Considering that IFRS are demanding and complex standards, strengthening enforcement both for accounting and auditing should be a priority for Uruguayan authorities in order to achieve strict compliance with IFRS and thus a quality in the financial information meeting the needs of investors with international exposure. In addition, it would ensure that the financial information presented by corporate borrowers to local banks is reliable, thereby strengthening the banking sector's ability to manage credit risk and report on it.

46. **An enforcement regime commensurate with Uruguay's objectives of greater international economic integration would include (a) a quality control mechanism at the level of the accounting profession, (b) integrating enforcement functions regarding listed companies into one agency and (c) a broader scope of statutory audits.** These issues will be further discussed in Section VI.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

A. STANDARDS AS DESIGNED

47. **Uruguayan accounting standards for non-financial business enterprises correspond to IFRS 2003, with certain exceptions that are significant.** Since 2004, Uruguayan GAAP correspond to (a) Decree 103/91, which deals with the overall presentation of the financial statements; (b) Decree 164/04 (amended by Decree 222/04) which mandates IFRS 2003 except when they conflict with Decree 103/91; and (c) Decree 90/05 which sets specific provisions for the transition between the previous standards and the new ones. The main differences between Uruguayan GAAP and IFRS 2003 relate to the following issues:

- ***Presentation of the financial statements not geared toward users*** – The compulsory format of financial statements set out in Decree 103/91 is problematic in two ways: (a) it does not show the profit before tax and (b) it does not require comparative (i.e. prior year) information, which is in direct contradiction with IAS 1, *Presentation of Financial Statements* and the IFRS Framework. Because comparison with prior periods is a basic element of any financial analysis for investment of credit purposes, the usefulness of the financial statements to analyze the company's financial condition properly is limited.
- ***A proper cash flow statement as defined by IFRS is optional*** – Instead of a cash flow statement, companies can present a statement of sources and uses of funds, which does not show the breakdown of cash flows by activities (operating, investing and financing); this type of statement is less useful by investors and users assessing the financial condition of a company.

These differences limit the usefulness of Uruguayan financial statements for investment and credit purposes. In practice, investors and lenders are required to perform unnecessary burdensome manual operations to be able to use the financial information. Accordingly,

amending Decree 103/91 and requiring a modern presentation of the financial statements by all Uruguayan companies, meeting the current needs of investors, should be a priority for the Authorities.

48. **Since they were adopted by Uruguay in 2003, IFRS have substantially evolved and it would therefore be in Uruguay's interest to adopt the most up-to-date version.** Between 2003 and 2005, five new IFRS standards were issued and 14 existing IAS standards were either amended or repealed. The version of IFRS currently in use worldwide ("IFRS 2005") is widely acknowledged to reflect considerable improvements vis-à-vis the 2003 version. The main differences between the 2003 and 2005 versions of IFRS are presented in Box 3. Assessing and quantifying the impacts of applying the 2005 version on the financial position and performance of Uruguayan companies entails a number of detailed calculations which are not carried out as part a ROSC. Nevertheless, the magnitude of the changes as described in Box 1 implies potentially significant financial impacts for Uruguayan companies. Moreover, these differences hinder the comparability of the financial information prepared by Uruguayan enterprises with recognized international benchmarks (IFRS or US GAAP), especially for investors with a foreign background.

Box 3 – Main changes in IFRS since 2003

In 2001, the EU decided to require IFRS for financial reporting by all listed companies, effective on January 1, 2005. The adoption of IFRS by the EU has dramatically increased the scope of their application worldwide. In addition, several other developed countries, including Australia and New Zealand decided recently to adopt IFRS as well.

In this context, the IASB launched in 2003 an "improvement project" designed to (a) bridge differences with US GAAP as part of a convergence process mutually agreed with the US Financial Accounting Standards Board (FASB) and (b) take into account the experience of using IFRS, which had been fairly untested until the beginning of this decade, as only a few countries had mandated the use of IFRS until then. This resulted in a new version of IFRS being issued in March 2004. Later on, additional amendments to the standards were made and a new revised version was issued in March 2005 ("IFRS 2005"). The main changes since 2003 are summarized hereunder:

- *Presentation of the financial statements* (IAS 1) – Among several changes, the notion of non-operating (or "exceptional") items in the income statement has been eliminated, as it was considered to invite misinterpretation or manipulation.
- *Accounting policies, changes in accounting estimates and errors* (IAS 8) – The new version of IAS 8 is more rigorous on the need to disclose the effects of changes in accounting policies and corrections of prior period errors.
- *Business combinations* (IFRS 3, superseding IAS 22) – Under the new standard, the goodwill resulting from an acquisition should no longer be amortized; instead, the amount of goodwill is to be tested each year for impairment, resulting in a charge in the income statement only if such impairment is found to exist.
- *Related-party disclosures* (IAS 24) have been strengthened especially with regards to management compensation and an obligation was created for management to substantiate the assertion that related-party transactions were concluded on an arm's length basis.

- *Financial instruments* (IAS 32 and 39) – These two standards stirred much controversy especially in the banking sector when they were issued. They have been amended on a number of key aspects in the 2004 issue of IFRS and again in August 2005 with the issuance of IFRS 7, *Financial Instruments: Disclosures*. Significant aspects of those changes include: (i) an increased level of disclosure; (ii) a new way of accounting for instruments that have both an equity and a debt component; (iii) clarification and detailed guidance on the measurement of impairment losses; (iv) the possibility for companies to opt for the use of fair value for all its financial assets and liabilities; and (v) the accounting for hedges of foreign currency, interest rate and other risks.
- *Possibility of alternative treatments* – Several alternative accounting treatments that IFRS 2003 allowed have been eliminated in the latest version, including (i) the use of the Last-In-First-Out (LIFO) method for valuing inventories, (ii) the capitalization of foreign exchange losses (now mandatory), and (iii) the presentation of correction of errors as part of the current year earnings (now forbidden).
- *New topics covered by the standards* – 3 other new standards (IFRSs 2, 4 and 5) were issued by the IASB on March 31, 2004, dealing respectively with share-based payments (e.g. stock options), insurance contracts, and non-current assets held for sale and discontinued operations. The latter new standard (IFRS 5) is the one that could have the most impact in Uruguay since stock options are still uncommon in Uruguay and IFRS are not applied in the insurance sector.

49. Considering that further integration with the EU, the US and other major economic partners is one of Uruguay's current priorities, and since investors, lenders and potential business partners in those countries always prefer working with the more up-to-date version of international standards, which they observe themselves, moving toward the 2005 issue of IFRS and implementing the changes described in Box 2 would seem like a natural choice for Uruguay.

50. **Accounting standards currently applied by banks in Uruguay are substantially different from IFRS.** As noted previously, accounting standards applicable by banks and other financial institutions when reporting to the SIIF and to their shareholders and the public are contained in the SIIF-issued Accounting Norms.⁴¹ Based on the review of the latter and discussions with the main commercial banks and audit firms in Uruguay, the most significant differences between the SIIF Accounting Norms and IFRS relate to the following issues:

- *Provisions for loan losses (IAS 39)* – Under SIIF Accounting Norms, paragraphs 3.8 and 3.12, loan-loss provisions should be recorded at a minimum on the basis of a matrix which requires fixed provisioning rates to be applied to various categories of loans according to indicators such as payments past due and the existence of guarantees. Such an approach differs from the one set out in IAS 39, *Financial Instruments: Recognition and Measurement*, which focuses on estimated future cash flows based on a qualitative analysis of the credit risk. In practice, this can lead to significantly different amounts. The impact of this difference on the local banks' financial position could not be assessed by the ROSC team, because those banks have not estimated provisions based on estimated future cash flows under the IAS 39 approach.⁴²

⁴¹ *Normas Contables para Empresas de Intermediación Financiera*. The SIIF Accounting Norms (which can be accessed online at http://www.bcu.gub.uy/autoriza/siernp/ernp_normas.pdf) are structured as an accounting plan (*plan de cuentas*), with general principles for the recognition, measurement, presentation and disclosure of accounting information (*normas generales*) and detailed instructions for each caption of the financial statements.

⁴² For foreign banks, which do apply IAS 39 or similar methods for group reporting purposes, anecdotal evidence indicates that the difference is immaterial or limited.

- *Intangible assets and deferred charges (IAS 38)* – SIIF Accounting Norms allow several types of charges (reorganization, charges “which deferral is authorized by the BCU”) to be capitalized that would be treated as period expenses under IAS 38. Such internally-generated or “soft” assets are usually not recognized by investors and lenders as representing real values.
- *Deferred taxes (IAS 12)* – SIIF Accounting Norms do not explicitly require deferred taxes to be accounted for, and the review of bank financial statements published for fiscal year 2004 shows that local banks do not usually record them. This could represent significant potential negative impacts on the banks’ equity, especially as they often revalue their properties, possibly implying that capital adequacy ratio requirements would not be met if IFRS were to be applied.
- *Securities investments and other financial instruments (IAS 39)* – Although the SIIF Accounting Norms have been recently aligned with IFRS and set broadly similar rules for measuring and presenting securities investment, differences still exist. One of them has to do with the conditions for not recognizing potential losses on fixed-income securities, which are less stringent than under IAS 39. Additionally, Uruguayan banks are not obliged to recognize all derivatives as IAS 39 requires.
- *Level of disclosure (various IASs, including IAS 1)* – In general, SIIF Accounting Norms require less detailed disclosure in the financial statements than IFRS. This applies to changes in accounting policies, employee benefits, income taxes, property and equipment, related-party transactions, risk management policies, etc.
- *Miscellaneous* – The SIIF Accounting Norms are silent on a number of types of transactions and the compulsory chart of account does not specifically provide for the accounting of such transactions. This applies in particular to leases and business combinations (in addition to deferred taxes as mentioned above). Besides, as in the case of enterprises no comparative information is required; this limits the usefulness the financial statements for their potential users.

Taken as a whole, the differences in accounting methods described above can have material impacts on some of the key indicators of a bank’s financial situation or performance (e.g., debt and net asset value). They make it more difficult for investors, especially international ones, to rely on the bank financial statements. Moreover, bank financial statements prepared under the current norms are not geared toward external users such as investors, depositors, and employees. Closing some of the gaps discussed above would contribute to improving the confidence in Uruguay’s financial entities thereby supporting the objective of enhancing the country’s business climate.

51. **The SIIF is considering further aligning its Accounting Norms with IFRS in the near future, in order to strengthen financial reporting by banks in Uruguay.** The SIIF has initiated in 2005 a consultancy project to carry out a detailed assessment of the differences between its Accounting Norms and IFRS, with the objective of eliminating differences whenever possible, with appropriate consideration given to the particulars, if any, of Uruguay’s banking sector. The priority areas identified for this consultancy are disclosure, financial instruments, intangibles, employee benefits, deferred taxes and price-level accounting. This initiative by the SIIF is welcome as reducing the current gap with IFRS will help strengthen the banks’ accounting and reporting practices, thereby allowing those institutions to improve their efficiency and risk management, facilitating SIIF’s role as bank supervisor and providing more comprehensive and accurate financial information to the market. This will contribute to the current efforts to restore the stability of Uruguay’s banking sector.

52. **In the insurance and pension fund sector, prevailing accounting rules also depart from IFRS on important aspects.** Besides the issues of presentation already noted for enterprises and banks (absence of comparative information, etc.), several differences between SSR-issued Accounting Norms and IFRS involve the recognition and measurement (valuation) of key types of assets and liabilities in the insurance industry, including securities investment, receivables, property and insurance liabilities. Additionally, insurance companies are neither required nor permitted to record deferred taxes. These differences with IFRS could involve significant amounts. As regards pension funds' accounts (i.e. the contributors' funds managed by the AFAPs), differences with IFRS exist in the presentation of the various types of assets held by these funds and in the fact that most transactions are recognized using the cash basis of accounting rather than the accrual basis.

53. **Accounting standards in Uruguay are the same for all types of enterprises, ranging from listed companies to SMEs, even though the latter are expected to follow much simpler rules.** The only difference at present has to do with the two IASs that specifically identify listed companies as the only entities required to apply them (IAS 14, *Segment Reporting* and IAS 33, *Earnings per Share*). The fact that legislation should set financial reporting requirements for SMEs commensurate with their smaller size, simpler transactions, and narrower range of stakeholders is commonly acknowledged worldwide. On that basis, the IASB has initiated in July 2003 a project to develop a simplified version of IFRS for SMEs. As the project stands at the moment, simplification would involve a lower level of disclosure and eliminate some of the complex options provided in IFRS, especially those based on the use of fair values. The lack of an appropriate financial reporting framework for SMEs is an impediment to their ability to provide accurate and reliable financial statements, which limits their capacity to access credit and long-term capital.

B. OBSERVED REPORTING PRACTICES

54. **The ROSC team reviewed the financial statements published by 30 Uruguayan companies with a view to assess actual reporting practices.** The sample of company financial statements was established randomly and included the following (number of entities):

- a) **Listed companies** (10) – Financial statements issued on or after June 30, 2005, under Decree 162/04 (i.e. under IFRS 2003, with the exceptions noted in Para. 47 – half of these were half-year financial statements). The main objective was to assess to what extent IFRS 2003 were effectively observed;
- b) **Non-listed enterprises** (10) – Financial statements issued as of December 31, 2004 or a more recent date, prepared under Decree 105/91 (i.e. before the adoption of IFRS 2003). These financial statements are available at the public registry managed by the AIN. Except in two cases, they were not audited and were only accompanied with a compilation report. The objective here was to evaluate the overall presentation of the financial information prepared by non-listed enterprises in Uruguay;
- c) **Banks, insurance companies and pension funds** (6) – Audited annual financial statements prepared under regulatory accounting standards. The purpose of this review was to assess compliance with regulatory accounting rules; and
- d) **State-owned enterprises** (4) – Audited financial statements issued under Ordinance 81 (i.e. IFRS 2003). The objective of the review was the same as for listed companies.

The main findings arising from the ROSC review of financial statements follow:

55. **The review of listed companies' financial statements shows a high level of observance, although the quality of those statements is still uneven.** In most cases, the financial information was comprehensive and relevant, giving adequate coverage to some of the topics where compliance with IFRS is the most challenging for companies when preparing their financial statements, including impairment of assets, segment information, financial instruments and taxation. The review confirmed the discrepancies between the Uruguayan version of IFRS and IFRS 2005 as discussed before (especially regarding the absence of comparative information). Besides, it evidenced several departures from Uruguayan GAAP, and in one case raised serious doubts on the faithfulness of the income statement to the company's performance. Departures observed relate to the following issues:

- **Missing disclosures** – The main problem identified was the omission in notes to the financial statements of required disclosures including (a) accounting policies (IAS 1), especially on the treatment of inflation—which often gave rise to material adjustments of the income—and the method for assessing asset impairment; (b) the description of the company's risk management and hedging policies (IAS 32); (c) the date of authorization for issue of the financial statements; (d) contingencies (IAS 37); (e) earnings per share (IAS 33), a critical financial indicator for investors required for all listed companies, was rarely provided and (f) explanations on the main captions of the income statement were seldom provided. The notes to the financial statements must be comprehensive and precise so that the users can gain a proper understanding of these statements and make informed decisions on their basis. Incomplete and sub-standard notes can also trigger investors and lenders suspicion, impeding them from relying on the financial statements.
- **Income tax** – A company had recorded as a profit of the period a deferred tax benefit related to the utilization of tax losses carried forward from prior years. This treatment had the effect to bring the net income for the period from a loss to a profit. Based on the information available, it seems that such benefit should have been recognized as an adjustment of the equity and not as income of the period. In any event, considering its material impact on the net income, this item should have been highlighted in the notes, and the rationale for the way it was accounted for should have been explained.
- **Financial instruments** – The notes to one set of statements indicated that the company had discounted a receivable for which it still retained the credit risk. Although the notes did not provide a clear explanation of the accounting for the sale of the receivable, it was implicit that the receivable had been “derecognized” (i.e. taken out of the balance sheet), in spite of the fact that the transaction did not qualify for de-recognition. The implication of this treatment is an underestimation of the company's financial debt.

56. **The review of the non-listed companies' financial statements gives a clear indication that until 2004 the quality of their financial statements was fairly poor overall.** The final statements in most cases fell short of IFRS on virtually all the topics covered by the IASs that were not required (see Appendix). Out of the 10 financial statements reviewed, one was claimed to be in accordance with IFRS, although in practice it did not comply with a number of important provisions of the standards. This confirms that the adoption of IFRS 2003 was a giant leap forward for Uruguay, and emphasizes the challenge that applying the newly adopted standards represents for the private sector.

57. **The reviewed financial statements of banks, insurance companies and pension funds provided comprehensive information, although of lesser quality than required by IFRS.** No case of apparent, material departure with the SIIF, SSR or DMVA Accounting Norms arose from the review. Even though the financial statements reviewed had significant disclosures, they fall

short of IFRS in a number of areas, especially with regard to financial instruments, the description of risk management policies, and related-party transactions. These differences reflect the fact that BCU's accounting rules are prudential in nature and geared toward supervision, not providing information to shareholders, depositors and third parties; this is commonplace in Latin America, where the new focus on "market discipline" recommended by the Basel Committee with regard to commercial banking has yet to be put in practice.

58. **The overall presentation of state-owned enterprises' 2004 financial statements was good, although in one case the auditors raised a number of issues reflecting on the reliability of the financial statements.** In three cases out of four reviewed, the information provided was broadly comparable to that of listed companies. In the case of the fourth SOE, the audit report highlighted as much as eight issues and was inconclusive (disclaimer of opinion). The review also noted the following:

- **Comparative information** – Contrary to most private companies reviewed, SOE financial statements did present comparative information and had a very user-friendly lay out.
- **Audit reports** – Two companies did not publish their audit reports even though such audits did take place. In addition to the case mentioned above of disclaimer of opinion, another of company's audit report contained a material qualification relating to several foreign investments.
- **A number of disclosures required by IFRS were missing** – These included the components of cash and cash equivalents (IAS 7), employee benefits (IAS 19), details of foreign exchange gains and losses (IAS 21), interest rate for borrowing costs capitalized (IAS 23), management compensation (IAS 24), risk management policies (IAS 32), and relevant explanations on contingent liabilities (IAS 37).
- **Impairment of assets** (IAS 36) – Except in one case, the financial statements did not indicate whether assets had been tested for impairment, and if loss of value had been recognized.
- **Other** – In one case, loans were not carried at amortized cost and other financial instruments were not measured at fair value, as required by IAS 39. Moreover, one company made no tax allocation (in equity) to a transaction recognized in equity.

Overall, the above shortcomings in SOE reporting practices stem from the fact that, apart from the role assigned to the TCR; these are rather loosely regulated, with financial statement audits by a professional firm being voluntary.

59. **Several audit reports reviewed had a qualified opinion, which means that the financial statements could contain material errors.** Of the 39 financial statements published by the BCU for fiscal years ended December 31, 2004 or June 30, 2005, 9 had a qualified audit reports and in two of those cases, the auditor abstained from giving an opinion. This is a relatively high incidence of both problems. Audit reports with qualified opinion or no opinion at all tend to be relatively infrequent in countries with strong enforcement regimes, as companies would rather adjust their accounts than being exposed to the potentially negative consequences of a qualified audit report. The frequent occurrence of qualified audits also points to a low level of enforcement of enterprises' financial reporting obligations, and to the need for a more robust enforcement. It sends a negative signal to the market and has a detrimental effect on investor and lender confidence and the country's investment climate. Stronger enforcement of IFRS by the respective agencies would normally lead to a lesser degree of occurrence of qualified audit reports. This would contribute to bolstering investors' and lenders' confidence in Uruguay's corporate financial reporting, thereby favorably affecting the investment climate.

IV. AUDITING STANDARDS AND PRACTICE

60. **Uruguayan auditing standards are close to international standards (ISA), although they lag in relation to the most current version of ISA.** As a result of Pronouncement no. 13 by the CCEA (Para. 39 above), the version ISA in force at the time has been made compulsory for all financial statement audits in Uruguay (on the stock market however, the most current version of ISA is required⁴³). CCEA Pronouncement no. 13 dates back to 2000; in the meantime, the international audit standard-setter (IAASB) has issued eight new ISAs, some of them considered to be important, which are therefore currently not in force in Uruguay. Additionally, a number of ISAs have been amended since 2000, especially ISA 240 on fraud. Current ISAs not applicable in Uruguay include the following:⁴⁴

- **ISA 260, Communications of Audit Matters with those Charged with Governance** – This standard is particularly important to clarify the auditor’s responsibility to give a timely feedback to audit committees, boards of directors and other governance bodies within the company on sensitive matters such as identified misstatements, issues involving material risks and internal controls, the appropriateness of accounting policies;
- **ISA 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement and ISA 330, The Auditor’s Procedures in Response to Assessed Risks** – The fact that these two standards are not applied in Uruguay implies that audits conducted in accordance with Pronouncement no. 13 are likely to place less emphasis on audit risk, which is considered one of the most critical aspects of an external audit nowadays. Indeed, the auditor’s ability to detect problems that could materially affect their investment—such as intentional misstatement in financial reporting and other forms of fraud—is essential to investor’s confidence, particularly in the wake of the corporate scandals that took place worldwide, especially in the US over the last five years;
- **ISA 545, Auditing Fair Value Measurements and Disclosures** – One of the main features of IFRS, as opposed to traditional GAAP, is a more widespread use of “fair value” to account for assets such as property (IAS 16), investment securities (IAS 39), investment property (IAS 40), and agricultural assets (IAS 41). Moreover, IFRS 3, *Business Combination*, and, to a lesser extent, IFRS 1, *First-Time Adoption of IFRS*, require ample use of fair values. Accounting techniques based on market values and other forms of fair value are widely used in countries applying US GAAP or IFRS and international investors and lenders expect the financial information to heavily rely on fair value. It is therefore critical for Uruguayan accountants that they become accustomed to appraise these, especially if they want to align their practices with those of accountants from industrialized nations. Accordingly, the CCEA should adopt ISA 545 as soon as possible;
- **ISA 701, Modifications to the Independent Auditor’s Report** – The changes brought by this new standard and the conforming amendment to ISA 700 include the furthering of the auditor’s responsibility in ensuring that the financial statements are not misleading even if they comply with the accounting principles mandated by local laws and regulations. This could be particularly relevant in those areas (e.g. financial sector) and

⁴³ Securities Market Regulations, Article 9.

⁴⁴ In addition, ISA 505, *External Confirmations* was issued. A large part of it corresponds to an expanded version of Part B of ISA 501 under its previous version, which is applicable in Uruguay.

on those specific aspects (e.g. comparative information) for which IFRS has not been adopted yet in Uruguay;

- **ISA 710, Comparatives** – Given that comparative financial information is not required under Decree 103/91, the absence of this standard in Uruguayan is less of a problem at present. Nonetheless, since comparative information is expected to become a generalized practice in Uruguay to meet the needs of investors, the adoption of ISA 710 by all Uruguayan auditors is highly desirable; and
- **ISQC 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information (...)** – In 2005, the IAASB, which is the standard-setter for ISAs, issued its first International Standard on Quality Control (ISQC). Quality control of audit work—both in terms of the quality assurance system that a firm sets up and the quality control procedures applied to individual audit engagements—is a fundamental aspect of the audit practice.

61. **Several systemic factors tend to hamper the observance of ISA in Uruguay, including:**

- **A relatively narrow market base and low demand for audit services in Uruguay** – Even though no statistics are currently available, the percentage of non-listed companies that opt to have their financial statements audited instead of merely “compiled” is widely acknowledged to be low among the audit profession. This view is corroborated by the fact that out of 28 sets of financial statements requested and obtained from the AIN, 10 of which were reviewed by the ROSC team (see Para. 54 b), only five (i.e. less than 20%) were audited. This means that most licensed accountants have relatively few opportunities to conduct independent audits, which makes it all the more difficult and lowers the incentives for them to maintain the specific skills required for that type of activity as opposed to other types of accounting services (tax returns, bookkeeping, etc.);
- **The absence of a system of quality control of audit work outside the firms themselves** – As noted in Para. 44, except to a limited extent in the banking sector and aside from the firm’s internal procedures, there is no mechanism in place to ensure that practicing auditors comply with ISA and observe quality assurance procedures consistent with those set out by IFAC (ISQC 1 and ISA 220);
- **A relatively low accountability regime** – Under Uruguayan law, accountants cannot be liable for cases of noncompliance with accounting and auditing requirements (except if such noncompliance is part of a criminal operation). In practice, civil lawsuits against auditors are unheard of in Uruguay, which is consistent with auditors not being obligated to take professional liability insurance. The BCU regulations on external auditors establish sanctions, but these only go as far as prohibiting an auditor (individual or firm) from practicing in a BCU-supervised entity, which means that sanctioned auditors can still practice in non-financial enterprises, which represent the vast majority of companies. Moreover, audit committees, whose role is considered essential to ensure that external auditors fulfill their responsibilities to deliver an audit that meets the needs of the stakeholders, are still infrequent in Uruguay. In that sense, the BCU’s requirement since 2004 that each bank set up an audit committee⁴⁵ is a positive initiative.

Favorable characteristics in Uruguay’s accounting and auditing environment—including a good level of university accounting education, intense efforts to disseminate international standards,

⁴⁵ SIIF Circular 1901, February 2004.

and the fact that financial statements are publicly available through the REC, which helps deter noncompliance—mitigate the weaknesses discussed above. Further aligning Uruguay’s auditing practice with ISA will require pursuing the capacity building efforts initiated under *Proyecto Convergencia* and some form of enforcement mechanisms within the profession. By doing so, the audit profession will greatly contribute to the objectives of reinforcing the quality of corporate financial reporting in Uruguay, which is a key ingredient to restoring investor confidence and ensuring the stability of the banking sector.

62. **The review of published financial statements raises certain issues regarding compliance with ISA.** In one case, the text of the audit report contained numerous changes to the standard wording provided in ISA (NIA) 700, *The Auditor’s Report on Financial Statements*. Finally, except for the aforementioned income tax issue, none of the issues discussed in paragraph 39 above was mentioned in the respective audit reports. A majority of the departures from applicable standards noted during the ROSC review were not mentioned in the corresponding audit reports. Some of the departures from IFRS should have given rise to qualifications in addition to those already reported by the auditors, especially those involving (a) accounting treatments disclosed in the notes that were in clear contradiction to IFRS or (b) the omission of disclosures explicitly required by IFRS (e.g., earnings per share, risk management policies, specific accounting policies).

V. PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

63. **Financial statement users interviewed during this ROSC acknowledge the progress made over the recent period but voiced some concerns regarding the quality of financial reporting.** Such recent actions as the adoption of IFRS (albeit incomplete) and the introduction of financial statements and external auditors registries are perceived as very positive steps towards facilitating investing, lending and commercial activities. Nevertheless, a number of users indicated that the accuracy of financial statements presented by local companies was uneven, adjustments to the balance sheet or income statements being often needed to portray the company’s financial position and/or profitability correctly. Issues of specific concern for interviewed stakeholders with respect to corporate financial reporting included: (a) an undue influence of tax rules on the financial statements; for instance, when companies do not reflect loss on their financial statements because these losses are not immediately tax deductible); (b) the reliability of auditors is perceived as uneven; (c) the business community’s lack of awareness on the importance of transparent and accurate financial reporting; (d) the fact that users in general have received little training to use IFRS-based financial statements (e) the existence of significant “inflationary” income related to the accounting scheme systematically applied in Uruguay to present inflation-adjusted financial statements, for which users often feel they do not have sufficient transparency, thereby hindering the confidence they place in those statements.

64. **Users point to shortcomings in the financial statement registry (REC), particularly frequent noncompliance by companies.** Uruguay’s only credit bureau, *Liga de Defensa Comercial*, relies heavily on the REC, which confirms its usefulness. However, some stakeholders are concerned that several types of companies (especially sole proprietorships) are not required to file. Besides, even in the case of commercial companies (*sociedades comerciales*) compliance with filing obligations is seen as low (one source estimates that about 40% of such companies comply). Finally, users of the REC call for an easier access to the financial statements and if possible the possibility to download data to allow automated treatments instead of just receiving copies of the financial statements that require the data to be processed manually as is currently the case.

VI. FINDINGS AND RECOMMENDATIONS

A. PRINCIPAL OBSERVATIONS

65. **Uruguay has significantly strengthened its accounting and auditing environment over the recent years and efforts are under way to continue that trend.** Recent improvements in the statutory framework and capacity building efforts to strengthen the accounting practice include the adoption of almost all IAS standards and related interpretations in their version as of 2003, and a comprehensive technical assistance project co-funded by the MIF and the profession. Nevertheless, in order for Uruguay to further integrate its economy with the large industrialized countries, as well as to make its business climate more conducive to foreign investment, several weaknesses in the current arrangements should be addressed.

66. **There is room for consolidating Uruguay's statutory framework for accounting and auditing.** There are multiple laws, regulations and standards and insufficient distinction between public-interest entities and SMEs. Different accounting, reporting and auditing regimes apply to Uruguayan enterprises depending on their sector or legal form, including specific provisions for cooperatives and the meatpacking industry. In the enterprise (i.e. non-financial) sector, the same standards are applicable for all types of entities irrespective of their size (SME or large company). Consolidating these various laws and regulations would help clarify the legal framework for investors, lenders, auditors, regulators and the companies themselves, which would be beneficial to the business climate. It could also help reduce the cost of doing business in the country.

67. **The other main findings of the ROSC Accounting & Auditing in Uruguay follow:**

- (i) State-owned enterprises (SOE), which play a major role in Uruguay's economy, providing most essential services, are governed by specific provisions of the Constitution, laws and regulation. SOEs are audited by the public sector auditor (Court of Accounts) and, most of the times, by a private audit firm, on a voluntary basis.
- (ii) Uruguay's securities market is still at an incipient stage, with a very small market capitalization (\$100 million) and less than a dozen bonds traded on the two stock exchanges of Montevideo. The main challenge the exchanges face at the moment to develop listings and trading levels is a lack of investor confidence. The supervision of listed companies is a shared responsibility of the National Audit Office (AIN) and the Central Bank (BCU), which is not optimal and weakens the enforcement regime.
- (iii) Non-listed companies are not legally required to have audited financial statements. However, BCU regulations require banks to obtain such audited statements from their larger corporate borrowers, regardless of whether they are non-listed.
- (iv) Uruguay is one of few countries in Latin America to require non-listed companies to file their financial statements with an official registry accessible to the public. Smaller companies are exempt from this obligation. In the financial sector, banks and pension funds are required to publish their audited financial statements; for insurance companies, only balance sheets and incomes statements are published, without the audit report.
- (v) Listed companies are required by law to appoint a *síndico*, with wide ranging oversight functions that overlap with the work of external auditors, including the issuance of an opinion on the financial statements. The added value of *síndicos* (to whom the law does

- assign some minority protection functions) to the oversight of the financial reporting process is often seen as limited.
- (vi) Uruguay's accounting profession has garnered a good reputation both locally and throughout Latin America. The accounting professional body, CCEA (*Colegio*), which is the oldest association on the continent, has had a prominent role setting standards for accounting, and even more so for auditing.
 - (vii) Accounting education is a strong tradition in Uruguayan universities. However, licensing requirements are not at par with international best practices as codified by IFAC, which include professional examination, professional experience and, after the license is initially awarded, continuing professional development (CPD).
 - (viii) Notwithstanding the adoption of IFRS, Uruguay's drive toward stronger integration in the world economy poses several challenges to the profession. One is building its technical capacity so as to cope with IFRS and the demand for higher quality corporate financial information, which in turn will enable banks to monitor credit risk more effectively and create conditions favorable to attracting foreign investment. Another challenge is strengthening the audit practice through enforcement actions and an enhanced professional licensing process, comparable to international benchmarks. The absence of mandatory affiliation to CCEA is perceived by the profession as a significant drawback in attempting to achieve those goals. Nonetheless, the profession's strong image should provide a sufficient incentive for its members to commit to a higher level of professional standards, as this will not only protect this image but could also enhance it on a broader international level. The CCEA has received the financial support of the Multilateral Investment Fund (MIF) to help it address some its current challenges including increasing its ability to use IFRS.
 - (ix) CCEA's ethical standards were issued in 1944, which shows that the profession attached importance early on to professional conduct. Sixty years later, there is a need to update the standards with current conditions.
 - (x) In 2004, Uruguay adopted IFRS in its existing version at the time (except for the requirement to present comparative information). This was an important step forward. Since then, IFRS have been thoroughly modified to meet the needs of the international community. In view of Uruguay's strategic objective of greater economic integration on a worldwide level, the best solution would be to continue on the path of convergence with global standards and adopt the most recent version of IFRS.
 - (xi) General-purpose accounting standards are set in Uruguay through Presidential Decrees. The decrees are drafted by a commission (CPNCA) headed by the AIN. The CPNCA has neither the adequate resources nor clear and sufficiently detailed terms of reference. Therefore it cannot play the role of a standard-setter even in the context of the adoption of IFRS. Enhancing CNPCA's role as a standard-setter is necessary if Uruguay is to keep abreast of the most current version of IFRS.
 - (xii) The Central Bank (BCU), which regulates the whole financial sector including the stock market, plays an important role in the field of accounting and auditing in Uruguay. In the absence of a professional licensing system, BCU had established a registry of external auditors whose members are often considered elite within the profession. Even though auditing is a critical process for Uruguay's financial sector, other in-country stakeholders

besides the BCU (including CCEA and the stock markets) should play an active role in regulating the audit profession in the country.

- (xiii) Accounting standards for financial reporting by banks and insurance are set by the BCU. The same set of principles and rules applies for prudential and for general-purpose reporting. They show substantial differences with IFRS which the BCU is considering eliminating in the medium term.
- (xiv) Listed companies are required to publish legal-entity and consolidated financial statements, but the consolidated statements are not required to be audited. Consolidation is not required from SOEs, banks, insurance companies or non-listed enterprises.
- (xv) Except in the financial sector where the BCU requires that ISA be used, there is no legal definition of an audit of financial statements, in terms of objectives, content and form of reporting. The CCEA which is a *de facto* standard-setter for non-listed enterprises has adopted a prior version of ISA which omits several significant new standards released by the IAASB in 2004 and 2005.

B. RECOMMENDATIONS

68. The main objective of this ROSC assessment is to assist the Uruguayan Authorities in strengthening the private sector's accounting and auditing practices as part of a broader effort to (a) make the business environment more attractive for FDI and foster capital market development; (b) further Uruguay's economic integration internationally; and (c) improve SOE governance and accountability. The policy-based recommendations arising from the assessment of existing practices will be discussed during a roundtable to be organized with the Authorities and in-Country stakeholders in Montevideo. A Country Action Plan identifying specific activities for the implementation of the report's recommendations will be developed then, under the aegis of the MEF and with the assistance of the World Bank and other international development partners including the MIF. The recommendations of this ROSC follow:

69. **Adopt IFRS in full for financial reporting by all public interest entities and, in their simplified version, for SMEs.** The different rules dealing with accounting at present in the enterprise sector should ultimately give way to IFRS as the single set of standards for all enterprises in the country. This will simplify and clarify Uruguay's accounting regime. For SMEs, the IASB is currently developing a simplified version of IFRS which is expected to be released as draft in 2006 and as final in 2007 or 2008; Uruguay should adopt these SME-IFRS once they become available. This would allow issuers and auditors to refer to IFRS, thereby enhancing investors' confidence in applicable standards and thus in the financial statements.

70. **Specifically for the banking and insurance sectors, accounting standards should be fully aligned with IFRS, after a reasonable period of transition.** Whether the financial statements are issued to regulators (banking or insurance), or to private sector users (investors, lenders, depositors, etc.), in both cases these statements pursue broadly similar objectives, i.e. to provide fair presentation of the reporting entity's financial position, performance and cash flows. In addition to allowing comparability on an international level, IFRS are widely acknowledged to the best basis to meet those objectives and the needs of investors, lenders and other users of the financial statements for business decisions. The main challenge in harmonizing current BCU-issued accounting rules probably relates to loan loss provisioning, one of the most critical areas of accounting in the banking sector. From a prudential standpoint, the application of IFRS in the

banking sector, if properly monitored, would provide the supervisor with a more accurate assessment of the credit risk based on an in-depth analysis of each bank's loan portfolio. The SIIF's project to study the impact of IFRS should serve as the initial phase in the transition toward full adoption. In the insurance sector, the fact that the IASB has yet to issue a comprehensive standard dealing with the specific features of insurance companies⁴⁶ may imply a longer transition period than in the banking sector. For those who use the financial statements for business decision purposes, adopting IFRS would enhance their understanding of, and their confidence in, the general-purpose financial statements issued by Uruguayan banks and insurance companies.

71. Make the CPNCA an effective standard-setter by granting it administrative autonomy and adequate resources, so as to streamline the adoption of IFRS in Uruguay and eliminate the current two to three-year time lag. Even though Uruguay has decided to adopt IFRS rather than developing its own sets of standards, adopting IFRS is not an automatic step, as it involves several activities that fall naturally in the realm of CPNCA. These activities include (i) actively participating in the IASB standard-setting process, providing feedback to the IASB when it issues draft standards for comments; (ii) ensuring new or revised IFRSs or IASs are compatible with the laws of Uruguay; (iii) developing guidance to apply the standards; and (iv) interpreting specific circumstances not foreseen by the standards. Increasing CPNCA's resources—mainly thorough financial contributions from its members—would allow it to dedicate much more efforts at the early stage of the standard-setting process, when standards are being designed. Moreover, considering its limited resources, the CNPCA should cooperate with other Latin American standard-setters in order to share the cost of the standard-setting process especially with regard to the development of specific guidance. Making the CPNCA an effective standard-setter would greatly facilitate the observance of IFRS in Uruguay, which is central to the country's efforts to make its business environment more conducive to foreign investment and furthering its integration in the world economy.

72. Strengthen the enforcement of listed companies' financial reporting obligations so as to enhance compliance with IFRS. Desirably, the enforcement functions of AIN and BCU insofar as they relate to listed companies should be combined in a single agency with adequate resources. At a minimum, it is important that the securities market regulator (DMVCA within the BCU) and the company regulator (AIN) reach a formal agreement to coordinate their respective enforcement actions. Integrating existing resources for enforcement of listed companies' financial reporting obligations would make it possible to follow risk-based approaches to enforcement and to coordinate off-site reviews with on-site inspections. Stronger enforcement will lead to a higher level of adherence with IFRS, thus providing the market with higher quality financial information inline with the expectations of international investors.⁴⁷

⁴⁶ IFRS 4, *Insurance Contracts* is considered a transitional standard by the IASB itself. The IASB has announced that it would release an exposure draft for a standard dealing with insurance contracts by the end of 2006.

⁴⁷ In their comments to this ROSC, both AIN and BCU have expressed the view that effective enforcement of corporate financial reporting by listed companies could be achieved through enhanced coordination and cooperation between the two agencies, without combining their enforcement functions related to the securities market. Nonetheless, international experience, including in Argentina, suggests that AIN could be in charge of enforcement regarding non-listed companies and that the securities market regulator (i.e. currently BCU/DMVCA) be in charge of enforcement for all listed companies.

73. **Require large non-listed companies to file audited financial statements with the AIN registry (REC).** Considering the incipient stage of development of Uruguay's securities market and the objective to boost this development, improving the quality of large non-listed companies' financial reporting is critical not only to enhance the transparency of the corporate sector as whole but even more importantly, to create more favorable conditions for the future listing of these companies. Moreover, many of the large non-listed companies already provide audited statements to their banks, but those companies are not obligated to publish the audit report, which nonetheless is an essential piece of information for those who use these financial statements, which include credit bureaus, suppliers, employees, and potential investors. To determine which companies, in addition to banks, insurance companies, pension funds, and listed companies, should provide audited statements, on objective measures of their size, such as total revenues, total assets or total number of employees should be used.

74. **Update CCEA's auditing and ethical standards by adopting the most current version of ISA and IFAC's ethics code.** The CCEA should initiate the process toward adopting the ISAs issued since 2004. This will require some training especially for the standards dealing with audit risk and quality control. In addition, all audit reports issued in Uruguay should strictly comply with ISA 700 and ISA 701, including by stating that ISA are applied. Adopting IFAC's *Code of Ethics for Professional Accountants* would be particularly beneficial insofar as the code covers several important issues, including independence and conflicts of interest, which the CCEA's ethical standards of 1944 did not cover. In addition, IFAC code's guidelines help accountants solve ethical dilemmas that they are likely to face in the practice and therefore to strictly abide by the profession's fundamental principles of independence, integrity and objectivity. Adopting IFAC's code of ethics would therefore help reduce the risk of failures in audits for ethical reasons, thereby contributing to the goal of enhancing investors' and lenders' confidence in the financial information produced by Uruguayan companies.

75. **Introduce a certification process similar to the one in place in Mexico or in the US as the basis for the registration of all statutory auditors.** Audits of financial statements for statutory purposes, including for banks, insurance companies, pension funds, listed companies, large non-listed companies, and SOEs, should meet high standards of quality which largely depends on the technical skills and competence of the persons who conduct the audit. Accordingly, there should be a formal process for qualifying auditors, consistent with IFAC's education standards, i.e. including a final examination, a requirement for minimum professional experience and continuing professional education. Although professional certification would represent a cultural change for the accounting profession Uruguay, a strong incentive for its adoption should be aligning the country's professional standards with those applied by most industrialized nations and a number of emerging economies.

76. **Establish a system of independent oversight for all statutory audits, involving BCU, CCEA, AIN and other key stakeholders.** The series of corporate failures particularly in the US has underscored the importance of independent oversight to ensure that statutory auditors not only have adequate capabilities and professional competence but also strictly comply with auditing and ethical standards, to adequately fulfill their functions. Reliance on the assurance that auditors provide on the corporate financial information is an essential component of investor confidence nowadays. Many countries have introduced such an oversight system since 2000⁴⁸

⁴⁸ Including the US (the Sarbanes-Oxley Act of 2002 established the Public Company Accounting Oversight Board), Canada, and most EU countries (France, Germany, the United Kingdom, etc.). In Latin America, El Salvador established an Accounting and Auditing Oversight Board (*Consejo de*

and the IFAC, the accounting profession's international body, has established one within its organization.⁴⁹ The oversight system should fulfill the following main functions:

- Qualifying statutory auditors – The license to conduct audits of financial statements of all public interest entities would be awarded by the oversight board on behalf of all interested parties (BCU, AIN, etc.), on the basis of a certification process discussed above;
- Monitoring the process for adopting ISA and the IFAC code of ethics; and
- Quality control and enforcement of professional standards – Active enforcement of auditing and ethical standards has become an essential part of a modern accounting and auditing regime, apt to enhance the confidence placed by investors and lenders in Uruguay's corporate financial reporting. The oversight board would conduct on-site reviews to ensure that statutory auditors have adequate quality assurance mechanisms in place and comply with ISA and the IFAC code of ethics. Disciplinary proceedings would be defined to address identified cases of non-compliance.

77. **The independent oversight system entails several benefits for the accounting profession, regulators and domestic companies.** From the accounting profession's standpoint, it would further establish its credibility vis-à-vis investors and lenders and the local business community and internationally. Moreover, it would provide a venue for enhanced cooperation with the BCU and AIN toward developing a single framework for auditing regulation in Uruguay. From the BCU's standpoint, the oversight would increase the accountability of external auditors outside the financial sector, especially those who audit large borrowers and are currently subject to no particular qualification or quality control requirements. It would also help free-up resources for supervision. As for the private sector, the oversight system would help strengthen confidence in the local business; this would make it easier for domestic companies to raise long-term funds at a lower cost.

78. **Different approaches to establishing independent oversight are possible.** These should be discussed between AIN, BCU's supervisory arms (SIIF, SSR and DMVCA), CCEA, stock exchanges, commercial banks, investors, etc., in order to identify which ones fits best the needs of Uruguay. Addressing this issue should be one of the priorities of the Country Action Plan. One option would be setting-up an independent agency established by law and solely accountable to the authorities (as the PCAOB in the US), although this solution involves high costs and is probably more adapted to larger economies with deep stock markets. In the UK, oversight is one of the many functions of a specialized institution (Financial Reporting Council) also charged with standard-setting and enforcement of financial reporting for all types of private entities including banks, listed and non-listed enterprises. Adopting such a model in Uruguay would require either a change in the laws or the financial sector supervisory arms' agreement to delegate some of its functions. In El Salvador, for instance, the Accounting and Auditing Oversight Board is a six-member board under the Ministry of Economy, with broad representation of all key stakeholder groups including the financial sector regulator, the government and the accounting profession.

79. **Consolidated financial statements should be systematically prepared, when applicable, and audited.** Consolidated financial statements provide a comprehensive picture of an economic group's key financial indicators whereas the "legal-entity" (i.e. unconsolidated) only

Vigilancia de la Profesional de Contaduría Pública y Auditoría) in 2000. Spain had established one as early as in 1989 (*Instituto de Contabilidad y Auditoría de Cuentas*).

⁴⁹ Public Interest Oversight Board (PIOB).

provide a partial if not distorted view. Consolidated statements are therefore considered by most investors and other users as more important than the legal-entity ones for their decision making. Article 89 of the company law (LSC) should be amended to include the explicit requirement that consolidated statements, when applicable, be audited. Moreover, other articles of the LSC dealing with financial reporting should explicitly mention that the board of director and *síndicos* are accountable for consolidated and legal-entity financial statements.

80. **Strengthen financial reporting and auditing within SOEs. In that respect, the Authorities should reach an agreement with all SOEs whereby these would have their financial statements audited by an audit firm in addition to, and in coordination with, the TCR.** The reasons for having a private accounting firm as auditor in addition to the TCR include (a) the fact that the TCR's mandate with respect to SOEs is mainly the control over budget execution, (b) the benefit of having timely audits and (c) industry expertise that can be acquired from large to medium-sized audit firms, which they in turn gain through a wide domestic clientele and the international networks they are most of the times affiliated with (by contrast, the TCR is specialized in public sector-related issues, which are less relevant to SOE audits). An ad-hoc structure could also be set up within the MEF, to monitor SOE financial reporting, follow-up on all significant issues reported by external auditors and on their timely resolution.⁵⁰

81. **Improve the effectiveness of the financial statements registry (REC) by (a) extending the obligation to submit annual financial statements to other types of companies than those covered by the LSC (b) enforcing companies' compliance with obligation to file and (c) making the financial statements accessible online.** The obligation for a business entity to publish its financial statements should be grounded on its economic significance rather than its legal form. Requiring all large to medium-sized companies to file with the registry (REC) irrespective of legal form would contribute to a level playing field in the private sector. By making financial information available for a broader array of entities to investors, banks, etc., it would also facilitate investing and lending activities in Uruguay. To encourage compliance with the obligation to file with the REC, AIN should impose fines more systematically and the Tax Authorities could require proof of filing with the REC.

82. **Any mandatory publication of financial statements in gazettes and newspapers should be foregone in favor of the use of internet.** Internet access is widely developed in Uruguay's investment, banking and business community. Moreover, the financial statements of banks, listed companies and pensions funds are already available on BCU's user-friendly website.

83. **Audit reports should be systematically published.** When a financial statement audit has been conducted at a company, it should not be allowed to publish financial statements without the audit report, as this amounts to withholding critical information that the financial statement users would need to be aware of for their decision making. This particularly applies to insurance companies and SOEs.

84. **Mandate the rotation of individual auditors and partners of audit firms in order to safeguard auditor independence.** This requirement, which is common in many countries including some within Latin America, would apply to all statutory financial statements audits. The audit firm would have to propose a new partner in charge of the audit engagement. If the

⁵⁰ France's *Agence des Participations de l'Etat* or the UK's Shareholder Executive provide interesting examples for such structure, which would have to be tailored to Uruguay's characteristics.

auditor is a sole practitioner, the company would need to appoint a new person or firm.⁵¹ Rotation should occur after a minimum number of years (e.g., five or six), so that the auditor could capitalize on its experience.

85. **Clarify the function of *síndico* or *comisión fiscal* and eliminate redundancy with the external auditor's role.** The current overlap between *síndicos* (or *comisiones fiscales*) and auditors is a source of confusion and redundant costs. One solution would be to combine the two functions and eliminate any role that could be seen as impairing independence. On the contrary, the *síndico* could be relieved from the responsibility to issue an opinion on the financial statements, which should be done solely by the auditors.⁵²

86. **Harmonize academic curricula for accounting and auditing with IFAC's education standards.** This is all the more important since the degree of *contador público* is currently the only substantial condition to practice accounting. It would be equally important in the context of the professional certification discussed in Para. 75, serving as the starting point for the certification process. Strengthening Uruguay's academic curricula would help enhance future practitioners' technical ability to operate with international standards, whether already applicable in Uruguay or to be adopted in the future.

87. **Insofar as they support the strategic objectives mentioned in Para. 68, applying the recommendations of this ROSC is expected to benefit a wide array of in-country stakeholders, including:**

- ***Private enterprises*** – Increasing investors' confidence in corporate financial reporting will ultimately open new opportunities for local enterprises to access long-term financing at a lower cost;
- ***Local investors*** – Full convergence with IFRS and ISA is one of the conditions to make Uruguay's stock exchanges more attractive to investors, especially those with international background. A better environment for new listings and increased levels of trading, will enhance investment opportunities for domestic investors;
- ***The local banking sector*** – Increasing the reliability of listed and non-listed enterprises' financial statements will facilitate bank intermediation and help the banking sector better manage credit risk;
- ***The public sector*** – Reinforcing SOE accounting and auditing practices is an important component of the public sector's financial management agenda;
- ***Uruguay's accounting profession*** – Introducing quality assurance arrangements and taking vigorous actions to enhance technical competence in the accounting profession will elevate the confidence that investors and corporate entities place in the profession. This will lead to an increased recognition and perceived value of services rendered by Uruguayan professionals which in turn will facilitate an increase in revenues for these professionals. This will also enable Uruguayan accountants to gain even more exposure on an international level;

⁵¹ Mandatory rotation of the audit firm itself is required by very few jurisdictions (mainly Brazil and Italy). The audit profession worldwide is generally opposed to such measure, arguing that thorough knowledge of a company's business and processes is paramount to quality audits and that forcing companies to change their auditor therefore adversely affects the quality of the audits especially in the years following the change.

⁵² The role of the *síndico* / *comisión fiscal* with respect to protection of minority interests is discussed in the Corporate Governance ROSC.

- ***AFAPs and Uruguayan retirees*** – Pension funds would be among the main beneficiaries of fully IFRS-based and reliable financial reporting by listed companies, as an essential tool to monitor the investment they make on behalf of the pension plans' beneficiaries. Additionally, a more active securities market would allow the funds to diversify their asset portfolio and therefore their risk; in turn, better diversification of pension plans' assets would contribute to safeguarding the long-term interests of the beneficiaries of the local pension plans.

Appendix – Timetable and Status of IAS and IFRS adoption in Uruguay

Standard Number and Title (standards issued before May 2004)	Year of adoption in Uruguay		
	1991	1993	2004
IAS 1 Presentation of Financial Statements	x ⁰		x*
IAS 2 Inventories	x ⁰		x*
IAS 7 Cash Flow Statements	x ⁰		x
IAS 8 Accounting Policies, Changes in Accounting Estimates, and Errors	x		x*
IAS 10 Events After the Balance Sheet Date	x		x*
IAS 11 Construction Contracts		x ⁰	x*
IAS 12 Income Taxes		optional	x
IAS 14 Segment Reporting		optional	x
IAS 16 Property, Plant and Equipment		x	x*
IAS 17 Leases		x	x*
IAS 18 Revenue		x	x*
IAS 19 Employee Benefits			x
IAS 20 Accounting for Government Grants and Disclosure (...)			x
IAS 21 The Effects of Changes in Foreign Exchange Rates			x
IAS 22 <i>Business Combinations (superseded by IFRS 3)</i>			x
IAS 23 Borrowing Costs			x
IAS 24 Related Party Disclosures			x
IAS 26 Accounting and Reporting by Retirement Benefit Plans			x
IAS 27 Consolidated and Separate Financial Statements			x
IAS 28 Investments in Associates			x
IAS 29 Financial Reporting in Hyperinflationary Economies			x
IAS 30 <i>Disclosures in the Financial Statements of Banks (superseded by IFRS 7 effective 2005)</i>			x
IAS 31 Interests In Joint Ventures			x
IAS 32 Financial Instruments: Disclosure and Presentation (a)			x
IAS 33 Earnings Per Share			x
IAS 34 Interim Financial Reporting			x
IAS 35 <i>Discontinuing Operations (superseded by IFRS 5 effective 2005)</i>			x
IAS 36 Impairment of Assets			x
IAS 37 Provisions, Contingent Liabilities and Contingent Assets			x
IAS 38 Intangible Assets			x
IAS 39 Financial Instruments: Recognition and Measurement			x
IAS 40 Investment Property			x
IAS 41 Agriculture			x
IFRS 1 First-time Adoption of International Financial Reporting Standards			(b)
IFRS 2 Share-based Payment			not adopted
IFRS 3 <i>Business Combinations (supersedes IAS 22 effective March 2004)</i>			not adopted
IFRS 4 Insurance Contracts			not adopted
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations			not adopted

"0" indicates IAS/IFRS standards adopted in Uruguay with some modifications

"*" indicates that the standard adopted in Uruguay in 2004 have since then been modified by the IASB

(a) Disclosure provisions superseded by IFRS 7 effective 2007.

(b) Optional. Minimum first-time adoption procedures should be observed if IFRS 1 is not applied (Decree no. 90/05)

IAS 3, 4, 5, 6, 13, 15 and 16 have been superseded by other standards and are no longer in force

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