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Panama: A Review of Accounting and Auditing Practices

Report on the Observance of Standards and Codes (ROSC)

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1 US\$ = 1 PAB (fixed parity)

Main Abbreviations and Acronyms

ACONTAP	Association of Public Accountants of Panama	IASB	International Accounting Standards Board
ACP	Panama Canal Authority	IFAC	International Federation of Accountants
AMUCOPA	Association of Women Public Accountants of Panama	IFRS	International Financial Reporting Standards
BHN	National Mortgage Bank	IPACOO	Autonomous Panamanian Cooperatives Institute
BVP	Panama stock exchange	ISA	International Standards on Auditing
CBI	International Banking Center	JTC	Technical Board of Accounting
CCF	Financial Coordination Council	MICI	Ministry of Commerce and Industry
CGRP	Office of the Comptroller General	NBFI	Non-banking financial institutions
CNV	National Securities Commission	NOCOFIN	Financial Accounting Standards Commission
CONEAUPA	National Council of Accreditation and Evaluation	PIE	Public interest entity
CPA	Certified Public Accountant	ROSC	Report on the Observance of Standards and Codes
CPA (Panama)	Authorized Public Accountant in Panama	SBP	Superintendency of Banks
CPD	Continuing professional development	SME	Small and medium enterprise
DEF	Department of Financial Businesses	SMO	Statement of Membership Obligations
DGI	Tax Administration	SOE	State-owned enterprise
FTA	Free trade agreement	SSRP	Superintendency of Insurance and Reinsurance
GAAP/GAAS	Generally Accepted Accounting Principles / Auditing Standards	UNESCPA	Specialized University for the Authorized Public Accountant
		UP	University of Panama

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Table of Contents

Main Abbreviations and Acronyms	iii
Acknowledgements	v
Executive Summary	vi
I. COUNTRY CONTEXT.....	1
II. INSTITUTIONAL FRAMEWORK FOR CORPORATE ACCOUNTING AND AUDITING	6
A. STATUTORY FRAMEWORK	6
B. THE ACCOUNTING/AUDIT PROFESSION	15
C. PROFESSIONAL EDUCATION AND TRAINING	19
D. ACCOUNTING AND AUDITING STANDARD-SETTING	20
E. ENFORCEMENT OF ACCOUNTING AND AUDITING STANDARDS.....	22
III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED	26
A. ACCOUNTING STANDARDS AS DESIGNED.....	26
B. OBSERVED REPORTING PRACTICES	28
IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED	29
V. PERCEPTIONS ON THE QUALITY OF CORPORATE FINANCIAL REPORTING	30
VI. RECOMMENDATIONS.....	32

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Executive Summary

This ROSC analyzes accounting, financial reporting and auditing practices within the corporate sector¹ in Panama, using International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks, and drawing on international experience and good practice in those fields.

With a population of 3.3 million, Panama is an upper-middle income country whose economy is mostly services-based and concentrated in the capital and close to the Canal. Panama has become one of the fastest growing economies in Latin America, experiencing real GDP growth averaging over 8.8% from 2004 to 2008.² This growth spurt has been led by construction, tourism, transport and commerce, and more recently an upturn in financial intermediation. The global economic crisis will likely lead to a significant slowdown in Panama's services-export oriented economy and overall economic uncertainty has increased substantially. Nevertheless, the planned investment arising from the widening of the Panama Canal (a large part of which will be financed with the Panama Canal Authority's own funds) is expected to provide a substantial fiscal stimulus that will partially offset the negative impact.³

This ROSC supports two main development objectives: (a) making Panama's business environment more conducive to private investment; and (b) advancing governance and financial accountability in both the private and public sectors. The report seeks to help the authorities address these issues by (i) improving the technical skills of accounting and audit practitioners, (ii) strengthening the regulatory framework governing accounting and audit practices in Panama, and (iii) developing the institutional capacity of the country's accounting professional bodies.

In 2005, Panama's Tax Code was amended to require taxpayers with annual revenues in excess of \$250,000 to submit financial statements using IFRS. The transition period to IFRS for medium and large companies is a fairly abrupt one (between 2 and 4 years were allotted, depending on the companies' annual revenues). Further, even relatively small companies (those with annual sales volume exceeding \$50,000 or with capital exceeding \$100,000) are subject to a mandatory statutory audit, which represents a significant administrative burden for them, with no clear, commensurate benefit. **Moreover, ISA was adopted and required for all statutory audits, under the same law.**

The requirement that even medium-sized companies prepare financial statements according to IFRS is not practicable. Most companies and their accountants ("preparers") have not been adequately prepared to comply with this

¹ The corporate sector includes both private and state-owned enterprises, and both financial and non-financial entities.

² World Bank, Program Document for a Proposed Development Policy Loan, "Protecting the Poor Under Global Uncertainty," Report No. 47208-PA, March 23, 2009.

³ A 2005 study on the Canal's economic impact found that it accounted for 18.6% of the country's GDP, 41.2% of its exports, and 28% of its fiscal revenues (per Economist Intelligence Unit, London, 2008).

requirement (outside of some supervised sectors where IFRS is already mandatory). Moreover, significant confusion remains about inconsistencies between tax rules and IFRS. The tax administration (DGI) does not have enough qualified staff members to effectively enforce compliance with applicable accounting standards for more than the largest companies.

Banks operating in Panama’s domestic market are subject to reporting requirements that are broadly in line with good international practice. In some areas, the Banking Superintendency’s prudential rules supersede and supplant IFRS; therefore users of bank financial statement may not have relevant information for assessing their financial performance, since prudential rules are not meant to fulfill that objective.

Non-banking financial institutions are regulated by a number of different government agencies. Compared to other Latin American countries, the regulatory framework is somewhat more fragmented. This diffusion of oversight responsibilities leads to statutory and regulatory fragmentation and, ultimately, regulatory weakness. Fragmentation is a problem insofar as it creates inconsistencies and duplication in the rules that companies are meant to follow, and it sows confusion among the companies’ accounting staff and among third-party users. Further, it makes the rules more difficult to enforce, especially if companies have lines of business that subject them to the oversight of multiple regulatory agencies.

Listed companies are subject to generally sound financial reporting and oversight requirements, as well as good-practice external audit and publishing requirements. One area for improvement is registration and oversight of external auditors, as previously noted by the IMF and the Corporate Governance ROSC (2004).

With regard to state-owned enterprises (SOEs), the overall level of financial disclosure is much higher than in most other Latin American and Caribbean countries, although the statutory framework could be improved. SOEs are required to prepare complete financial statements under government accounting standards which differ from IFRS. Several SOEs in effect are not required to undergo a financial statement audit, although some do so based on their obligations as recipients of donor funds or on a decision by management. The supreme audit institution, CGRP, collects and publishes annual financial information in a transparent fashion, which represents a regional best practice. In addition, a few public enterprises, including the constitutionally autonomous Panama Canal Authority, issue IFRS-based financial statements.

Non-listed, non-financial enterprises are not subject to significant disclosure requirements. Panama has a public registry (Para. 18), but it is optional to file annual financial statements there. Enterprises are not otherwise required to make their financial information available to the public. Although a requirement for non-listed companies to publish their financial statements is relatively unusual in Latin America, and such a provision involves practical difficulties, it should be considered good practice. Uruguay and El Salvador do have a requirement for unlisted companies to publish their financial statements.

With regard to Panama’s accounting/audit profession, the legal framework omits several key requirements adopted by many countries post-Enron. Two illustrative examples of these omissions are (i) the lack of an audit oversight system, including an auditor registration process and a system of audit quality assurance; and (ii) minimum education, practical experience and continuing professional development requirements that are not up to the standards of good practice embodied in the *International Education Standards for Professional Accountants*.⁴ New legislation to improve the statutes has been submitted to Congress, but even this proposal falls significantly short of good international practice.

An independent Accounting Technical Board (JTC) is responsible for issuing accountant licenses and overseeing the profession but, to date, the JTC has not issued any regulations relating to the adoption of IFRS or ISA. The tax authority (DGI) has published a translation of IFRS (2007). By publishing a specific version of IFRS in the Gazette without guidance on how to treat future updates to IFRS, the DGI has created uncertainty with respect to the binding nature of future IFRS updates. The only way to eliminate any ambiguity would be for the law to set out a general endorsement of IFRS in Panama and to require from a legally empowered standard-setter (i.e., currently, the JTC) to review and endorse any subsequent changes to IFRS. In addition, neither the DGI nor the JTC appears to have in place a robust process for adopting IFRS, which is problematic since IFRS are constantly changing. **In addition, the JTC suffers from capacity and financial constraints and is unable to perform most of its functions.**

Panama has four professional accounting bodies, which is unique in Latin America. This fragmentation tends to weaken the profession’s image and its ability to articulate clear positions to the public and policymakers. All of these organizations fall significantly short of IFAC’s Membership Obligations.

Most Panamanian accounting graduates do not receive significant instruction in IFRS, ISA or other relatively recent developments. Panama has taken steps to put in place minimum education quality standards and a system of evaluation, but these steps have not yet yielded tangible results.

A unique feature of Panama’s accounting landscape is the Authorized Public Accountant Specialized University, established by the country’s main accounting association. It offers accounting and auditing instruction by practitioners at international audit firms. However, it is not yet self-sustaining and graduates relatively few students.

Both the banking and the securities regulators have significant enforcement capacity. The insurance supervisor’s capacity to monitor compliance with accounting and auditing requirements in the insurance sector needs to be strengthened significantly.

⁴ The International Accounting Education Standards Board, operating independently under the auspices of the International Federation of Accountants (IFAC), produces the *International Education Standards for Professional Accountants*. <http://www.ifac.org/Education>.

Enforcement for other non-banking financial institutions, such as lending companies (*financieras*), financial leasing companies, and savings and loans, is weak.

But auditor oversight in the financial and securities sectors needs strengthening. This issue could be addressed in the short-term by the creation of an external auditor registration process, such as the unified auditor registry in place in Uruguay. Neither the JTC nor any of the professional associations monitors the quality of practice among its membership, and there are no requirements for internal firm-level quality assurance processes to ensure that accounting and audit firms are meeting acceptable standards of quality. The absence of enforcement mechanisms for sound auditing standards calls into question the reliability of these audits and, by extension, the usefulness of audited financial statements.

The banking and insurance supervisors have adopted a series of accounting provisions that conflict with, and take precedence over, IFRS. The financial statements of Panamanian banks and insurance companies would therefore portray their financial position much differently if they were prepared in accordance with IFRS.

A review of 21 sets of financial statements issued by public-interest entities (PIEs) showed a fairly high level of adherence with IFRS, although some departures were observed. Among listed companies, instances of non-compliance identified had to do mainly with insufficient or inadequate disclosures, as well as valuation of assets. The departures call for a more robust enforcement regime.

The review also raised a number of issues regarding compliance with ISA by the respective auditors. Adherence to ISA by Panamanian audit firms, especially small and medium-sized ones, is hampered by weak oversight of the statutory audit function. A workshop convening members of the accounting profession to discuss auditing practices in Panama (among other issues relevant to this ROSC) served to confirm this observation

Perceptions of the accounting and auditing profession within the business community are mixed at best. Lending institutions, business executives and regulators have doubts about the ability of Panama's accountants to apply IFRS, especially those working in small practices. Some point to the divisions within the accounting profession as a drag on its development.

This ROSC suggests certain principles to underpin efforts to reform and strengthen Panama's corporate financial reporting. Points of departure for enhancing corporate financial reporting and auditing could focus on: the following issues:

- (a) *Scaling and simplifying IFRS and audit requirements* such that SMEs are not subject to burdensome obligations without commensurate benefits to society;
 - (b) *Strengthening the JTC and adopting a clear adoption process* for future updates to IFRS and ISA;
 - (c) *Requiring external audits for all SOEs* as a matter of good practice;
 - (d) *Enhancing financial reporting and auditing enforcement* in supervised sectors;
- and

- (e) *Moving toward a professional certification* with a view toward integration with North American and other large overseas markets.

A country action plan (CAP) is expected to be developed as part of the finalization of this report, under the aegis of the Ministry of Economy and Finance (MEF), and possibly with the assistance of the World Bank and other development partners. The action plan will involve government policies as well as capacity development within the accounting profession and, to a lesser extent, regulatory agencies.

I. COUNTRY CONTEXT

1. **The review of corporate sector accounting and audit practices in Panama has been carried out as part of the Reports on the Observance of Standards and Codes (ROSC) initiative.** The main focus of the review is the institutional framework and professional environment that underpin private sector accounting and audit practices. The review also entailed a comparison of accounting and auditing standards mandated by the local legislation with the two benchmarks used for the reviews, International Financial Reporting Standards (IFRS⁵) and International Standards on Auditing (ISA⁶). The review did not cover government accounting standards and practices and the corresponding auditing issues.⁷

2. **Panama is an upper-middle income country with a population of 3.3 million and a GDP per capita of US\$5,909 (2007), whose economic activities are mostly services-based and concentrated in the capital or close to the Canal.** The Colon Free Zone, the Panama Canal and the International Banking Center contributed altogether 78.4% of GDP in 2006. Panama has become one of the fastest-growing economies in Latin America, experiencing real GDP growth averaging over 8.8% from 2004 to 2008.⁸ This growth spurt has been led by construction, tourism, transport and commerce, and more recently an upturn in financial intermediation. The global economic crisis will likely lead to a significant slowdown in Panama's services-export oriented economy and overall economic uncertainty has increased substantially. Nevertheless, the planned investment arising from the widening of the Panama Canal is expected to provide a substantial fiscal stimulus that will partially offset the negative impact.⁹

3. **Good governance issues are two of the Torrijos administration's five "Strategic Vision Pillars."**¹⁰ In 2004, President Martin Torrijos was elected for a five-year term, after running a campaign emphasizing the need to curb corruption and improve transparency. Since then, the government has worked (in partnership with the World Bank) on improving public sector financial accountability and the quality and availability of fiscal data, with the intent to converge toward international standards.¹¹ A joint

⁵ IFRS correspond to the pronouncements of the International Accounting Standards Board (IASB) and the International Accounting Standards (IAS) issued by its predecessor, the International Accounting Standards Committee, or amended by the IASB, as well as related interpretations.

⁶ ISA are issued by the International Auditing and Assurance Standards Board, an independent board within the International Federation of Accountants (IFAC).

⁷ These issues were reviewed under the Public Expenditure Management and Financial Accountability Review conducted jointly by the World Bank and the Inter-American Development Bank.

⁸ World Bank, Program Document for a Proposed Development Policy Loan, "Protecting the Poor Under Global Uncertainty," Report No. 47208-PA, March 23, 2009.

⁹ A 2005 study on the Canal's economic impact found that it accounted for 18.6% of the country's GDP, 41.2% of its exports, and 28% of its fiscal revenues (per Economist Intelligence Unit, London, 2008).

¹⁰ The Torrijos administration promulgated five "Strategic Vision Pillars" for 2004-09, which were: (1) Reduce poverty and improve income distribution; (2) Economic growth and more jobs; (3) Healthy public finances; (4) Development of human capital; and (5) Reform and modernization of the State.

¹¹ The World Bank's Country Partnership Strategy for FY08-10 provides an opportunity for the Government of Panama (GoP) to achieve more effective interventions, inter alia by developing and implementing tools for more strategic use of public resources and modernizing public financial

Country Financial Accountability Assessment / Country Procurement Assessment Report (CFAA/CPAR) report on Panama, published in December 2006, concluded that significant progress had been made in terms of the timeliness, scope and dissemination of quarterly budget execution, fiscal balance, debt and payroll reports, and annual financial statements. Nonetheless, there remains a need for improvement of the quality of financial statements (e.g., accounting standards, disclosures, and consolidation), and for the modernization of the managerial and accounting control of property, plants and equipment.¹² In this regard, the government has taken steps in recent years to improve its public sector accounting standards and align them with International Public Sector Accounting Standards (IPSAS).

4. **Panama is pressing forward with important regional and global integration initiatives.** The decision to widen the Panama Canal opens up the shipping channel to larger (“post-Panamax”) vessels from around the world. Panama and the US, its largest trading partner, signed a free-trade agreement (FTA) in 2007 that awaits ratification by the US. Panama also signed a trade agreement with the Central American countries in 2002; has a bilateral FTA with Chile and another one with Singapore, both signed in 2006; and separate bilateral FTAs with El Salvador and Honduras that were signed in 2007. In addition, Panama is participating in the negotiations for an FTA between Central American countries and the European Union. Regional and global integration are expected to give the economy an even greater boost—helping Panama to reduce poverty and inequality, and improve competitiveness.

5. **The current financial crisis has lowered growth forecasts substantially, yet Panama is relatively better positioned to weather the crisis compared to most countries.** Despite global economic conditions and the forthcoming political transition, Panama is expected to continue to pursue a sound medium-term macroeconomic policy. However, this can be hampered by inefficient use of public resources, a perceived lack of transparency, and limited access to credit—especially by small and medium enterprises (SMEs), which will be disproportionately affected by the crisis as banks focus credit on their larger clients with well-established businesses.

6. **Panama has a large International Banking Centre (CBI), with 90 banks operating locally and US\$63.7 billion in assets as of January 2009.** The liquidity position of the banking system during the financial crisis remains comfortable, on average, although there is dispersion in liquidity ratios across banks. A Banking Superintendency (SBP) was established in the mid-1990s to beef up supervision. Over the last decade, significant effort has been made to strengthen the regulatory framework and to move toward the Basel I accord on banking supervision. This provided the basis for renewed growth in local banking activities. All banks in operation at the beginning of 2009 were private institutions except for the state-owned *Banco Nacional de Panama*

management institutions and practices, among other things. Aligned with the Panama Strategic Vision pillars, this strategy emphasizes fiscal discipline, transparency and greater efficiency.

¹² *Panama Country Financial Accountability and Procurement Assessment Report*, Report No. 40496-PA, World Bank and Inter-American Development Bank, December 31, 2006.

(BNP) and *Caja de Ahorros*. Among private banks, 43 had general licenses, 31 had international licenses and 14 had representative-office licenses.

7. **In addition, the Panama stock exchange (BVP) has grown significantly since the early 1990s and its market capitalization was over US\$10 billion as of mid-2008.** The BVP has approximately 100 listed companies, with most of its activities concentrated in corporate bonds, private commercial paper and Treasury certificates. However its trading volume is still relatively low. A strong corporate financial reporting framework is essential to protect shareholders and therefore foster investors' confidence in Panama's markets and enterprises, and willingness to invest.

8. **Other significant types of regulated entities in Panama include:**

- ***Insurance and reinsurance companies***, which are regulated by the Superintendency of Insurance and Reinsurance Companies (SSRP) within the Ministry of Commerce and Industry (MICI).¹³ The insurance sector comprised more than 40 insurers, reinsurers or captive insurance companies, together holding more than \$1 billion in assets at the end of 2007 (the last year for which data are available).
- ***Credit union / cooperatives***, which are regulated by the Autonomous Panamanian Cooperatives Institute (IPACOOOP), an entity created by statute but which is administratively and financially autonomous from the state. They are a significant and growing financial segment in Panama, with approximately \$1 billion in assets at the end of 2007 (largely concentrated within a few large credit unions).¹⁴
- ***Lending companies ("financieras"), financial leasing companies, remittance companies and pawn brokerages***, which are regulated by the MICI's Department of Financial Businesses (DEF). These companies held approximately \$750 million in assets as of the end of 2007 (the latest year for which data are publicly available).
- ***Savings and loan institutions***, which are placed under the supervision of a state-owned enterprise, the National Mortgage Bank (BHN).¹⁵ There are just four savings and loan institutions operating currently, with approximately \$80 million in total assets.
- ***Microfinance institutions***, which may be set up either as banks (and thus be subject to SBP regulations) or as financial institutions (subject to the MICI's supervision under the DEF).

9. **Supervised sectors are regulated by a number of different agencies within the government**, as shown in Table 1. Compared to other Latin American countries the

¹³ The insurance, captive insurance, and reinsurance sectors are regulated through three laws: Law 59 of July 29, 1996; Law 60 of July 29, 1996; and Law 63 of September 19, 1996.

¹⁴ Source: IPACOOOP (<http://www.ipacoop.gob.pa/estadisticas.htm>. Accessed: 3/2/2009).

¹⁵ Law 39 of November 8, 1984. "*Por la cual se reorganiza el Banco Hipotecario Nacional*," modified *inter alia* by Board of Directors Resolution No. 8-3-2008.

regulatory framework is somewhat more fragmented. For instance, Colombia has one regulatory agency for its financial sector.

Table 1: Principal Supervised Sectors in Panama

Sector / type of entity	Total assets (as of end of 2008 unless otherwise noted)	Oversight agency (see table of acronyms)
Banking	US\$63.7 bn.	SBP
Securities	10.2 bn. ¹⁶	CNV
Insurance	1.1 bn. (2007)	SSRP
Credit unions	1.1 bn. (2007)	IPACOO
Pension fund administrators	123 mn.	CNV
Savings and loans	80 mn	BHN
Other NBFIs	750 mn.	MICI
State-owned enterprises	3.3 bn.	CGRP
Panama Canal Authority	4.7 bn.	Self-governed

10. **Panama also has a significant number of state-owned enterprises (SOEs), including the company operating the Panama Canal.** The Panama Canal Authority (ACP) is by far the largest SOE, with US\$4.7 billion of assets as of September 2008. A 2005 study on the Canal's economic impact found that it accounted for 18.6% of the country's GDP, 41.2% of its exports, and 28% of its fiscal revenues.¹⁷ The ACP is governed by specific provisions of the Constitution and statutes, and has a very strong governance structure, unusual for an SOE in Latin America. The other significant enterprises in which the state owns a majority interest do not enjoy the same degree of autonomy and their corporate governance is less clear. These entities represent major assets of the Panamanian State, worth US\$3.3 billion according to the government accounts for fiscal year 2008 (excluding the ACP), but also significant potential contingent liabilities. Strong financial oversight and corporate governance of SOEs is essential to ensure that these enterprises deliver adequate public services to citizens and local businesses in a fiscally sustainable manner.

11. **Based on the above, the ROSC A&A for Panama will support the following two primary development objectives: (a) making Panama's business environment more conducive to private investment; and (b) advancing governance and financial accountability in both the public and private sectors.** This ROSC seeks to help the authorities address these issues through (i) improving the technical skills of accounting and audit practitioners, (ii) strengthening the regulatory framework governing accounting and audit practices in Panama, and (iii) enhancing the institutional capacity of the country's accounting professional bodies.

¹⁶ Market capitalization as of July 2008.

¹⁷ *Panama: Country Profile 2008*. Economist Intelligence Unit, London, 2008, p. 17.

Table 2: Overview of Accounting and Auditing Requirements in Panama

Type of entity	Regulatory Agency	Accounting Standards	Audit Requirement	Auditor Rotation	Publication
Banks	SBP	SBP prudential rules and, in the absence thereof, IFRS or USGAAP	Yes; auditor subject to SBP approval	New audit team every 3 years	Annual F/S with notes published in national newspaper SBP publishes quarterly balance sheets and income statements on website.
Listed companies	CNV	IFRS or USGAAP ¹⁸	Yes; auditor not subject to CNV approval	New audit team every 3 years	Complete audited financial statements published on CNV's website.
Pension funds	CNV	IFRS or USGAAP ¹⁸	Yes; auditor not subject to CNV approval	New audit team every 3 years	Complete audited financial statements published on CNV's website.
Insurance companies	SSRP	SSRP prudential rules and, in the absence thereof, IFRS	Yes; auditor with at least 3 years of insurance experience	None	SSRP publishes annual balance sheets and income statements for each regulated entity on its website.
Non-banking financial institutions	DEF	IFRS	No	None	None
Savings and Loans	BHN	IFRS	No	None	None
Credit union cooperatives	IPACOOOP	"IPACOOOP cooperative accounting standards"	No	None	None
State-owned / public enterprises	CGRP MEF	General Standards of Government Accounting (Panama) ¹⁹ IFRS for the ACP	No	None	CGRP publishes complete financial statements with notes, but without auditor's report, on its website.
Non-listed companies	DGI	>\$250,000 in annual revenues: IFRS ≤\$250,000 in annual revenues: cash-basis	Yes, for companies with >\$50,000 in annual revenues	None	None

¹⁸ Foreign companies may use their own local GAAP, subject to reconciliation to IFRS or USGAAP.

¹⁹ Some SOEs elect to prepare IFRS financial statements instead, which is permitted by the CGRP.

II. INSTITUTIONAL FRAMEWORK FOR CORPORATE ACCOUNTING AND AUDITING

A. STATUTORY FRAMEWORK

A.1. Enterprise Sector (excluding SOEs)²⁰

12. **The Panamanian legal system is generally based on Spanish Civil Law, although Company Law is based on the (common-law influenced) Delaware model.** Companies in Panama are most commonly organized as corporations (S.A.), which are governed by Law 32 of February 26, 1927 and the Code of Commerce. Companies can also be organized as limited-liability corporations (S. de R.L.), which are governed by the new Law 4 of January 9, 2009²¹ and the Code of Commerce. Financial reporting and auditing requirements are contained in the Code of Commerce, rather than the company organization laws.

13. **Since 1997, Panama's Code of Commerce, as amended, requires all companies to prepare and issue complete financial statements within 120 days after the close of the fiscal year.** The financial statements include a balance sheet, an income statement, a cash flow statement and a statement of changes in equity.²² Penalties for not maintaining books of accounting range from \$100 to \$500 per month. Accounting books should be updated within 60 days following the end of every month. Complete financial statements including explanatory notes are not explicitly required by statute, although the requirement that financial statements be prepared according to “generally accepted accounting principles applied in the Republic of Panama” would imply the need for such notes. This term was not further defined within the law.²³

14. **Even relatively small companies are subject to a mandatory statutory audit, which represents a significant administrative burden for them.** According to the Tax Code, all companies with capital exceeding \$100,000 or with an annual sales volume greater than \$50,000 are required to undergo an annual statutory audit following auditing standards applicable in Panama and Panama's code of professional ethics for accountants. The audit report must accompany these companies' tax returns.²⁴

²⁰ For purposes of this report, “enterprise sector” refers to all commercial organizations (companies) operating outside the financial sector (i.e. other than banks, insurance companies, pension fund administrators, or other providers of financial services).

²¹ Previously, limited-liability corporations were regulated by Law 24 of February 1, 1966. These laws do not contain appreciably different provisions with respect to financial reporting or auditing.

²² Code of Commerce, Article 95. Described in DGI Resolution No. 201-1990 of July 21, 1998.

²³ Between 1978 and 1994, the Financial Accounting Standards Commission (*Comisión de Normas de Contabilidad Financiera*, or NOCOFIN) adopted 11 local accounting standards, the first of which declared that any areas not covered by these local standards would be governed by international accounting standards of the IASC (now IASB). Nonetheless, it was subsequently determined in two Supreme Court cases that NOCOFIN and its parent entity, the Accounting Technical Board (*Junta Técnica de Contabilidad*, or JTC), were not then empowered to issue binding accounting standards. See Para. 56.

²⁴ Fiscal Code, Article 712, Paragraph 1 and by Executive Decree 170 of 1993, as modified by Executive Decree 1143 of 2005.

15. **Panama is in the midst of a fairly abrupt transition to IFRS for medium and large companies.** In 2005, the Fiscal Code was amended to require that the tax administration (DGI) only accept tax declarations prepared on an accrual basis under IFRS.²⁵ A subsequent DGI resolution in 2007 specified a schedule for companies to comply with this requirement, with staggered implementation according to the companies' annual revenues:²⁶

- \$1,000,001 and greater: fiscal years beginning in 2007
- \$500,001 to 1,000,000: fiscal years beginning in 2008
- \$250,001 to 500,000: fiscal years beginning in 2009
- Companies with annual revenues up to \$250,000 are permitted to prepare their financial statements on a cash basis.

16. **The time allotted to shift to IFRS from the predominantly cash-basis rules that were previously applied was very short if compared with other countries that have adopted IFRS.** For the EU, where IFRS adoption only concerned listed companies, the transition covered four years. For New Zealand, it was over five years. For Brazil and Chile, it was four years. International experience has shown that, in order to be effective and orderly, the transition to IFRS requires three to five years and significant regulatory, outreach, research and capacity-building efforts led by the government.

17. **There is legally no distinction between general purpose financial reporting and tax reporting in Panama.** The same 2005 amendment to the Fiscal Code states that any companies that submit tax declarations that do not match the general purpose audited financial statements presented to banks or other financial institutions will be presumed fraudulent.²⁷ However, at least one global audit network's ("Big 4") local affiliate has interpreted this provision as meaning only that companies must present a *reconciliation* of the differences between their general-purpose financial statements and their tax returns, "given the differences that exist between the tax standards and IFRS."²⁸

18. **Non-listed, non-financial enterprises are not subject to significant disclosure requirements.** The Code of Commerce requires companies to keep their financial statements at their place of business, available for inspection by the competent authorities (not the public). It is optional for companies to place their audited financial statements with the public registry (*Registro Público*).²⁹ Enterprises are not otherwise required to make their financial information available to the public. They need not hold annual general meetings of shareholders or directors. In addition, the fact that Panamanian companies are not required to pay taxes on income generated outside of Panama means that the IFRS requirement imposed by the DGI does not apply to companies that report no Panama-source income. These and other aspects of Panama's commercial code and

²⁵ Tax Code, Art. 699, Para. 3, as amended by Law 6 of 2005.

²⁶ DGI Resolution No. 201-454 of February 14, 2007

²⁷ Law 6 of 2005.

²⁸ KPMG Panama, *Carta Informativa, "Declaración de Renta en base a Normas Internacionales de Información Financiera (NIIF)."* July 11, 2007.

²⁹ Code of Commerce, Art. 95 and 58a.

banking laws make it an attractive location for foreign businesses on account of limited disclosure requirements.³⁰ Although a requirement for non-listed companies to publish their financial statements is relatively unusual in Latin America,³¹ and this provision involves practical difficulties, it should be considered good practice.

19. **The DGI does not require companies that are part of a group to prepare separate legal entity financial statements** if the group has prepared consolidated financial statements.³²

A.2. Banking Sector

20. **Banks operating in Panama's domestic market are subject to high standards of financial reporting and prudential requirements.** The Banking Law requires local and international banks to submit audited financial statements to the SBP within three months following the close of the fiscal year. Financial statements are defined in the law to include a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and notes that include the most important accounting policies and other explanatory notes.³³ Banks must present unaudited quarterly financial statements to the SBP within 30 days after the end of each quarter. Banks must also present monthly reports containing assets, liabilities, earnings and prudential information. The SBP may also request financial information from any other entity that is part of the same economic group as a regulated bank. Within 30 days after presenting their annual financial statements to the SBP, banks must publish their financial statements, with the accompanying notes, in a national circulation newspaper and display them for 90 days in a visible location at each of their establishments within Panama. The SBP publishes the unaudited quarterly balance sheets and income statements on its website.

21. **The SBP's prudential requirements supersede and supplant IFRS (or USGAAP requirements) where they conflict.** In 1999, the SBP issued an accord stating that banks may present their financial statements using either IFRS or USGAAP,³⁴ however subsequent circulars and resolutions clarified that where either of these norms conflicts with the SBP's prudential regulations, the latter prevails.³⁵ Some prudential

³⁰ Panama is currently on the OECD's "gray list" of jurisdictions that have committed to the internationally agreed tax transparency standard, but have not yet substantially implemented it. *OECD Tax Haven Progress Report*, April 2, 2009, <http://www.oecd.org/dataoecd/38/14/42497950.pdf>. The Internet abounds with companies that boast of Panama's ease of incorporation and lack of financial disclosure requirements. These companies, with names like www.confidentialbanking.com and www.incorporatedoffshore.net sell "asset protection" or "tax minimization" services, according to their websites.

³¹ Countries who have introduced similar requirements include Argentina, Brazil (for corporations), Colombia, Mexico, and Uruguay. El Salvador requires publication of a balance sheet. Filing of annual accounts by all private commercial companies is a very common practice in Europe.

³² "Consultas absueltas por la Dirección General de Ingresos, Segundo Semestre 1998," July 8, 1998, No. 201.01.314. <http://www.dgi.gob.pa/documentos/CONSULTAS%20DGI%2098.htm> [Accessed Jan. 11, 2009]

³³ Chapter IX of Law-Decree 9 of 1998, as amended by Law-Decree 2 of 2008.

³⁴ SBP, Accord 4 of 1999.

³⁵ SBP, Circular 1 of 2006; reiterated in Resolution 1 of 2007 and in Circular 31 of 2007.

regulations on classification of loans and investments, and loan-loss provisioning, contradict IFRS in important ways. (See Section III, Accounting Standards as Designed and as Practiced.) Consequently, many banks' audited financial statements carry a proviso stating that they have been prepared according to "International Financial Reporting Standards, as modified by prudential regulations issued by the SBP." (See Section IV). This could mean that financial statement users may not have access to relevant information assessing the economic performance of these banks, since prudential reporting is not meant to fulfill that objective.

22. **Statutory audit requirements in the banking sector are broadly in line with good international practice.** Banks must appoint external auditors who are "specialized and with sufficient experience, in the opinion of the Superintendency," and must notify the SBP of their appointment. Statutory audits must be carried out under ISA. The SBP reserves the right to reject an independent auditor who lacks sufficient experience, specialization or independence to carry out their duties.³⁶ This practice, which is fully in line with international good practice, is meant to ensure that external auditors of banks meet minimum "fit and proper" conditions. Banks must rotate their external auditing team, including the signing partner (though not necessarily the entire firm) and all specialized personnel related to the audit, every three years. The latter rotation period is relatively short, especially if compared with US or European equivalent requirements. One individual, other than the signing partner, may remain on the audit engagement for an additional year.³⁷

23. **The SBP seems relatively well staffed for its supervisory role.** The SBP monitors enforcement of its regulations through off-site and on-site inspections, and has a relatively large and well-qualified inspection staff.³⁸ The off-site inspections team can request on-site inspections based on a number of prudential and other risk factors, including for misapplication of accounting rules. In the last three years, the on-site supervision unit has carried out an average of more than 150 inspections per year, including overseas inspections.

24. **The SBP has significant sanctioning powers at its disposal with regard to banks' financial reporting obligations, even though it has rarely exercised this authority.** The SBP may punish violations of the Banking Law or other regulations with sanctions ranging from a private warning, to a public warning, to fines up to \$1,000,000 and the cancellation of the bank's license. Within the last three years, there have been no sanctions imposed for violations of the financial reporting requirements.

³⁶ Chapter VIII of Law-Decree 9 of 1998, as amended by Law-Decree 2 of 2008.

³⁷ SBP Accord 1, 2002, Art. 9, as modified by Accord 6 of 2005.

³⁸ There are 87 technical staff members within departments of off-site supervision, on-site supervision, prevention and fiduciary duties. Technical staff members possess an average of six years of relevant experience, although most supervisors have much more.

A.3. Non-Banking Financial Institutions (NBFI)

25. **As previously mentioned, NBFIs are regulated by a number of different agencies within the government.** This diffusion of oversight responsibilities leads to statutory and regulatory fragmentation and, ultimately, regulatory weakness. Fragmentation is a problem because it creates inconsistencies and duplication in the rules that companies are meant to follow, and it sows confusion among the companies' accounting staff and among third-party users. Further, it makes the rules more difficult to enforce, especially if a multiplicity of regulatory agencies are involved.

26. **The financial reporting statutory framework for insurance companies is weaker than that of the main other supervised sectors.** The SSRP requires regulated entities to submit audited financial statements annually within four months of the close of the fiscal year. The laws do not specify an accounting standard, which by default means insurance companies are subject to the tax authority's rules requiring IFRS. However, the SSRP's prudential regulations differ from IFRS in certain key aspects (catastrophic risk reserves and statistical deviation reserves are counted as liabilities and deductible from income taxes) and the prudential requirements prevail. (See also Section III, Accounting Standards as Designed and as Practiced.) In addition, companies must submit quarterly reports on reserves, investments and solvency margins. The solvency margins are published quarterly by the SSRP in a national circulation newspaper and on the SSRP website. In addition, the SSRP publishes annual balance sheets and income statements for each regulated entity on its website, although the rest of the financial statements, the accompanying notes and the auditor's report are not published.

27. **With regard to external audit, the only SSRP requirement is that the external auditor have at least three years of experience in the insurance sector.** External auditors are not subject to any rotation requirements, and their hiring and dismissal need not be approved by the SSRP.

28. **The SSRP's enforcement capacity is comparatively weak and rarely, if ever, exercised.** The SSRP's Audit Department is responsible for monitoring compliance with accounting and auditing requirements. The law empowers the SSRP to impose fines of \$1,000 to 50,000 for failure to comply with financial reporting requirements or other regulations).³⁹ The SSRP indicated that it has not imposed sanctions on a supervised entity for inaccuracies or failure to comply with financial reporting requirements.

29. **Credit unions, although similar to banks in important ways, are subject to a lower level of regulatory oversight.** All credit unions are required to submit annual financial statements to IPACOOOP within 90 days after the close of the fiscal year. These are to be prepared according to cooperative accounting standards established by IPACOOOP, which differ from IFRS.⁴⁰ There is no requirement that these financial statements be audited, although a few of the largest credit unions do so in practice.

³⁹ E.g., for insurance companies: Law 59 of July 29, 1996, Title VII, Article 115. The laws governing captive insurance companies and reinsurance companies have similar provisions.

⁴⁰ Law 17 of May 1, 1997.

Similarly, although IPACOOOP has not established prudential rules for credit unions, it has signed a Memorandum of Understanding with the SBP whereby the largest credit unions and IPACOOOP receive training in prudential supervision of lending operations. There is no requirement for credit unions to publish their financial information, although IPACOOOP collects and publishes basic financial information aggregated to the provincial level. Proposals have been made to bring the largest credit unions under the SBP, but it is unclear whether this will be accomplished.⁴¹

30. Savings and loans institutions, which are not a significant segment of financial institutions at present, are subject to much more lax regulatory arrangements. In terms of financial reporting requirements, regulated entities are only required to hold an annual shareholders meeting during the month of January, to which the BHN must be invited. At the annual shareholders meeting, the president of the savings and loan must present annual financial statements for the previous year. Within 30 days following the annual shareholders meeting, the savings and loan must submit a balance sheet, an income statement and an auditor's report. The law and regulations are silent on the qualifications of the auditor, as well as any "fit and proper" or independence requirements. There are no requirements to publish these financial statements, and the BHN does not do so. There are no sanctions described in the law or regulations for failure to comply with financial reporting or other related requirements.

31. Other non-banking financial institutions (lending companies, financial leasing companies, etc.) are also subject to relatively weak oversight. The DEF requires these companies to submit audited financial statements, but the financial reporting standard is not specified, which by default means they are subject to the tax authority's rules requiring IFRS. The financial information that DEF collects is only reported by the DEF in the aggregate—financial reports by individual companies are not available. The DEF also collects additional financial information quarterly, however these data are primarily for statistical purposes and are not made public. There are no "fit and proper" or other requirements placed on external auditors, nor is there a requirement for companies to rotate their statutory auditor. There is no requirement for these companies to publish their financial statements.⁴²

A.4. Securities market participants

32. Entities associated with Panama's stock exchange are subject to generally sound financial reporting and oversight requirements.⁴³ Listed companies, brokerage

⁴¹ "Reformas a la Ley Bancaria y la Supervisión de Cooperativas en Panamá." *Boletín Informativo*, June 2008, Latin American Federation of Savings and Loan Cooperatives (*Confederación Latinoamericana de Cooperativos de Ahorro y Crédito*, or COLAC).

Zoraida Chong, "Cooperativas en busca de excelencia," *Diario La Prensa*, Suplemento Financiero, March 25, 2008.

⁴² Law 42 of July 23, 2001.

⁴³ A Corporate Governance ROSC was carried out by the World Bank in 2004 (see www.worldbank.org/ifa/rosc_cg_pan.pdf), characterizing the periodic reporting requirements as, "approaching international good practice." Since then, some positive reforms have been carried out. Some of the Corporate Governance ROSC's recommendations are the same as this A&A ROSC's

houses, investment societies, pension funds, and other firms associated with the stock exchange are supervised by the CNV.⁴⁴ Supervised entities must submit complete financial statements (including a balance sheet, income statement, statement of changes in equity, cash flow statement, and explanatory notes) annually. Companies must report under either IFRS or USGAAP and subsidiaries must be consolidated according to the requirements of IFRS or USGAAP, except in certain exceptional cases. An exception is made for foreign issuers, who may publish their financial statements according to the issuing company's national GAAP, however the CNV may ask for the reconciliation between the foreign issuer's GAAP and CNV-endorsed standards (i.e., IFRS or USGAAP). Although most companies prefer to report under IFRS, the option to report under USGAAP is retained because of the strong influence of the US model on Panama's commercial code and other laws.⁴⁵ In addition, issuers of securities must submit additional annual and quarterly narrative forms that describe liquidity, capital resources, income from operations and prospectus analysis. Finally, issuers must report any material event that may have occurred during the previous quarter.

33. CNV-regulated entities are required to follow good-practice publishing requirements. Annual and quarterly reports must be published in a national circulation daily newspaper, a national circulation periodical or specialized magazine, the company's website, or sent to each shareholder and investor (as long as any other interested party may solicit a copy of their own). Annual reports, of which the complete audited financial statements are an integral part, must be published and submitted within 3 months after the close of the fiscal year. Quarterly reports must be published and submitted to the CNV within 2 months after the close of the quarter. The CNV publishes the audited annual financial statements and the unaudited quarterly financial statements on its website.

34. Listed companies and other CNV-regulated entities are subject to external audit requirements that are in line with international good practice. The annual financial statements must be audited by an independent external auditor, who must be a licensed accountant or accounting firm. If the financial statements are prepared under USGAAP, the audit should be carried out under US generally accepted auditing standards (GAAS); if the financial statements are prepared under IFRS, then the audit should be carried out under ISA.⁴⁶ Auditors are required to follow the code of ethics for accountants written by the Accounting Technical Board in 1984.⁴⁷ This code of ethics is

recommendations—namely, the creation of an audit oversight mechanism and stronger enforcement of existing requirements.

⁴⁴ Law 1 of July 8, 1999 (as amended by Laws 42 of 2000, 29 of 2001, 11 of 2002, 45 of 2003 and 6 of 2005). Financial reporting requirements are also described in detail in CNV Accord No. 03-2005 of March 31, 2005).

⁴⁵ The requirement for Panamanian companies listed in the United States to prepare financial statements under USGAAP, or reconcile their IFRS-based financial statements to USGAAP, was removed by the US Securities and Exchange Commission effective March 2008. This action removed an important incentive for Panamanian companies listed in the United States to prepare USGAAP financial statements. At present, only one Panamanian company is listed in the United States (COPA Airlines, which follows USGAAP).

⁴⁶ CNV Accord 2 of February 28, 2000.

⁴⁷ Law-Decree No. 26 of May 17, 1984. "Por el cual se aprueba el Código de Ética Profesional para los Contadores Públicos Autorizados."

not as comprehensive or stringent as IFAC's Code of Ethics. Supervised entities must rotate their external auditing team, including the signing partner and engagement manager (though not necessarily the entire firm) and all specialized personnel related to the audit every three years. One individual, other than the signing partner, may remain on the audit engagement for an additional year.⁴⁸ Any change in the external auditor must be reported to the CNV within 15 days and must be accompanied by an explanation of the reason for the auditor's departure (along with other relevant information, such as Board of Director involvement in the decision and any conflicts with management that may have led to the separation). The names of the new audit team must be reported 30 days prior to beginning the audit of the annual financial report.

35. The lack of a robust auditor registration process is a critical weakness of the CNV's authority. The CNV does not have an auditor registration process, nor the right to reject the appointment of auditors whom they deem unqualified (only those who are not independent). Given the importance of qualified external auditors for sound financial reporting, auditor registration is considered a good practice internationally. The United States and most EU countries have established auditor registration processes under an independent audit oversight board.⁴⁹ Within the Latin America and Caribbean Region, for instance, both Brazil and Mexico have established auditor registration processes, offering examples of regional good practice.

36. The CNV contends that the securities law empowers it to sanction external auditors, however this authority is not clearly spelled out in law or resolution.⁵⁰ A 2007 IMF working paper also cited the CNV's lack of "explicit power over external auditors" as a shortcoming of Panama's regulatory framework.⁵¹ Such sanctions have been imposed only once, in a high-profile case involving a local affiliate of Arthur Andersen that was finally upheld by the administrative tribunal of the Supreme Court of Panama in 2005.⁵² The audit firm's lawyers disputed the CNV's authority to investigate or sanction external auditors, but the Supreme Court declined to hear their appeal. In sum, there remains some ambiguity as to the CNV's authority to investigate and sanction external auditors. (See also Para. 73.)

⁴⁸ CNV Accord 8 of May 22, 2000.

⁴⁹ In the US, the Public Companies Accountability Oversight Board (PCAOB) is responsible for auditor registration and oversight. Spain's Accounting and Auditing Institute (ICAC) is another example of a European independent audit regulator with an auditor registration process.

⁵⁰ The relevant sections of the Securities Law (Law 1 of July 8, 1999 as amended by Laws 42 of 2000, 29 of 2001, 11 of 2002, 45 of 2003 and 6 of 2005) are Articles 208, 263 and 266, which state that people or companies over whom a regulated entity "exercises control," including in the form of contractual authority, are subject to the requirements of the law.

⁵¹ Hemant Shah, Ana Carvajal, Geoffrey Bannister, Jorge Chan-Lau, and Ivan Guerra, "Equity and Private Debt Markets in Central America, Panama, and the Dominican Republic," IMF WP/07/288, p. 123.

⁵² See CNV Annual Report, 2005-2006, p. 38.

http://www.conaval.gob.pa/publicaciones/librosCNV/Memoria_2005_2006.pdf

The local affiliate of Arthur Andersen was the external auditor for the collapsed ADELAGE Group. A good summary of the ADELAGE case can be found in *Economist Intelligence Unit*, "Panama finance: Prominent bankruptcy spurs new legislation," March 9, 2001.

http://www.eiu.com/index.asp?layout=VWPrintVW3&article_id=1694824569

37. **The CNV has adopted voluntary corporate governance guidelines.** In 2003, the CNV approved an Accord recommending certain guidelines and principles of good corporate governance for its supervised entities. Among these was the formation of an audit committee, which would supervise the internal auditor and hire the external auditor among other duties. Other recommendations resemble the corporate governance requirements codified in the United States in the Sarbanes-Oxley Act of 2002.⁵³ These were merely recommendations, however, and it is not clear how many companies have adopted these corporate governance practices.

A.5. State-owned enterprises (SOEs)

38. **There are wide variations in the quality of the statutory framework that SOEs are required to follow.** SOEs can be set up either as corporations (S.A.) or as autonomous statutory bodies. The former operate as any other corporation except that their majority shareholder is the State. The latter are State entities with operational autonomy—they are not included in the general budget and they operate as commercial, for-profit entities. All SOEs, regardless of how they are set up, are required to prepare complete financial statements. The financial statements must be prepared under the 27 General Standards of Government Accounting issued by the CGRP.⁵⁴ A few SOEs (e.g., Panama Canal Authority, Electrical Transmission Company, Civil Aeronautical Authority, and the National Savings Bank), however, state that their financial statements are prepared under IFRS, which the CGRP accepts.

39. **Several SOEs in effect are not required to undergo a financial statement audit.** The CGRP is responsible for auditing all government entities, however it has limited resources and does not carry out audits of most SOEs. In any event, CGRP audits are carried out under Panama's Government Auditing Standards, which are focused on ensuring budgetary compliance. There is no requirement for state-owned enterprises to undergo external audits, although some do so based on their obligations as recipients of donor funds (e.g., the water and sewage authority, IDAAN) or based on a decision by management. These audits are carried out by private audit firms and are based on ISA or, occasionally, unspecified GAAS of Panama. There is no requirement that these external audits be disclosed publicly, and some are not. In fact, the CGRP's consolidated financial statements of SOEs are explicitly based on unaudited financial data.

40. **The Supreme Audit Institution, CGRP, collects and publishes quarterly and annual financial information in a transparent fashion, which represents a best practice at the regional level.** All SOEs submit monthly financial information and quarterly unaudited financial statements to the CGRP, which prepares consolidated financial statements of all government entities and publishes them on its website on a quarterly and annual basis (although this responsibility is in the process of shifting to the

⁵³ CNV Accord 12 of November 11, 2003.

⁵⁴ Law-Decree No. 234 of December 22, 1997. A project is underway within the CGRP to further align Panama's General Standards of Government Accounting with international public sector accounting standards (IPSAS).

Ministry of Economy and Finance). The quarterly and annual financial statements published on CGRP's website are complete (they include a full set of accompanying explanatory notes under the 27 General Standards of Government Accounting or whatever reporting standard is used). They do not, however, include the external auditor's report, even when one is available, which can be considered as a weakness considering the importance of disclosing that information to the users.

B. THE ACCOUNTING/AUDIT PROFESSION

41. **The legal framework for the accounting/audit profession in Panama omits many of the requirements introduced in the post-Enron era in many jurisdictions.** The profession in Panama is regulated by a specific law, the Law on the Accounting Profession of 1978.⁵⁵ Requirements for entry into the profession are minimal. To be admitted as an Authorized Public Accountant of Panama (or CPA (Panama)⁵⁶), one must have: (a) Panamanian citizenship; (b) a university degree with a specialization in accounting from either the University of Panama or another university that has been recognized by the University of Panama; (c) no pending judgments for crimes relating to the public trust or to property; and (d) no convictions for crimes relating to the public trust or to property during the last five years. Prior to the 1978 law, a university degree was not required to practice as an accountant. Accountants practicing prior to the law were allowed to continue practicing as accountants, but not as CPAs (Panama). By law, that means that they cannot practice as external auditors. Although there were around 650 of these non-CPA (Panama) accountants licensed in 1978, it is not known how many of them still remain in practice.

42. **An independent Technical Board of Accounting (JTC), under the MICI, is responsible for issuing accountant licenses, but it suffers from capacity and financial constraints and is unable to perform its functions effectively.** It has issued nearly 15,000 licenses in the 30 years since the law was passed. The registration process must be carried out by a lawyer and costs around \$200. As these accountant licenses need not be renewed, and the JTC suffers from severe staffing constraints, the JTC does not know how many licensed accountants are currently practicing. Knowing how many of its licensees continue to practice is a fundamental responsibility for any licensing board. The JTC and other policymakers need this information in order to be able to make data-driven decisions and for planning purposes (e.g., if it wanted to design a training program to teach IFRS to practicing accountants). The JTC cannot effectively communicate changes in law or survey its licensees if it doesn't know where they are or how many there are. And the JTC's lack of data on which of its licensed accountants are still alive and practicing hampers its ability to detect fraud, impersonation and other abuses.

⁵⁵ Law 57 of September 1, 1978.

⁵⁶ Panama refers to its authorized public accountants as "CPAs," however we refer to them herein as CPA (Panama) to avoid confusion with the US-based CPA certification, which is recognized internationally.

43. **The members of the JTC, acknowledging that the 1978 Law on the Accounting Profession is outdated, have drafted legislation to improve it, but even this proposal falls significantly short of good international practice.**⁵⁷ The draft bill adds a professional licensing examination or two years of professional experience to existing requirements, as well as expands the list of crimes that disqualify a candidate from obtaining an accountant license (e.g., major criminal offences), and extends the period of disqualification to seven years from five years following conviction. It also would expand the list of reserved functions (the current law stipulates that only accountants can perform accounting-related tasks such as bookkeeping, analysis of financial statements, and the review of income tax declarations) and increase the sanctions on the business community for hiring a non-accountant to perform accounting or auditing-related work. **The draft proposed bill was submitted to Congress in 2007, but it has not been brought up formally for consideration.**

44. **Panama has four professional accounting bodies, which is unique in Latin America.** Most countries have one or two accounting professional bodies. These bodies are briefly described in Table 3.

Table 3: Professional accounting bodies in Panama

Name	Date of Incorporation	Membership	Annual dues	Affiliation ⁵⁸
College of Authorized Public Accountants (<i>Colegio</i>)	1957	1,700	\$180	IFAC, AIC
Association of Authorized Public Accountants (ACONTAP)	1941	485	\$120	AIC
Association of Women Authorized Public Accountants (AMUCOPA)	1954	300	\$144	AIC
Movement of Independent Public Accountants (MOVICOP)	1993	200	\$75	None

Source: Colegio, Acontap, Amucopa and Movicop.

45. **This fragmentation tends to weaken the profession's image and its ability to articulate clear positions to the public and policymakers.** Broadly speaking, the *Colegio* represents the largest international audit firms and high value-added portions of the Profession. In addition to having significantly more members than the other professional bodies, it is the only one that is a member of IFAC. The *Colegio*'s resources and capacity provide significant organizational advantages vis-à-vis the other professional bodies. ACONTAP and AMUCOPA have smaller memberships, charge less in dues, and tend to represent university accounting professors and smaller practitioners. MOVICOP is a more recently established group that was apparently established in part to resist the imposition of international standards on the accounting and auditing profession.

⁵⁷ Draft Law No. 165 of 2007. "Anteproyecto consensuado de la Ley del Contador." The draft law is available on the ACONTAP website (<http://www.acontapanama.org>).

⁵⁸ International Federation of Accountants (IFAC) is an international organization of professional accounting bodies (<http://www.ifac.org>); the Inter-American Accounting Association (AIC) is a regional organization of professional accounting bodies.

MOVICOP is a vocal group that has gained outside prominence in the media and the courts and is often perceived as litigious.

46. **All of these organizations' entry requirements fall short of IFAC's Statements of Membership Obligations (SMOs – see Table 4).** The SMOs require a minimum education background, at least three years of professional experience under an experienced mentor, and the passing of a final exam for all licensed professional accountants. Panama's professional associations only require that their members hold an accountant license, which does not currently require passing an exam or any professional experience. The draft revised accounting law mentioned in Para. 43 would require candidates either to pass an examination **or** to have two years of professional experience.⁵⁹ Even though the *Colegio* is the only IFAC member body of the four, and therefore is the only organization bound by the SMOs, these SMOs represent statements of good practice that all four professional associations should consider adopting.

47. **Continuing professional development (CPD) is not mandatory for any of the professional associations.** Only the *Colegio* has a voluntary continuing professional development (CPD) program. Members who complete 120 hours of CPD over three years are awarded a certificate. The other professional bodies have a much more limited program of CPD activities or none at all. Mandatory continuing professional development to retain membership is required of the *Colegio* by IFAC under SMO 2, and is clearly good practice for any accounting professional body.

48. **The current code of ethics, in force since 1984, is not as comprehensive as IFAC's Code,** which includes a broad risk-based framework and specific examples to guide members of the Profession in navigating ethical conflicts that are not covered explicitly in the Code. Aside from being an example of good practice, the adoption of IFAC's Code is among the seven SMOs that IFAC requires its member bodies (including the *Colegio*) to follow.

49. **No provision of the statutes or professional body regulations requires statutory auditors, let alone licensed accountants, to obtain professional indemnity insurance.** Such insurance is a necessary feature in a system where accountability for negligence or failure to adhere to applicable legal provisions and professional standards is expected from licensed practitioners.

⁵⁹ Draft Law No. 165 of 2007. “*Anteproyecto consensuado de la Ley del Contador.*” The text of the draft law is available on the ACONTAP website (<http://www.acontapanama.org>).

Table 4: Compliance with IFAC Statements of Membership Obligations (SMOs)

SMO No.	Issue Covered by SMO	Comments	Ref.	Compliance with SMO
1	Quality Assurance	No quality assurance mechanisms implemented by JTC or professional associations.	Para. 70	None
2	International Education Standards for Professional Accountants (IES) related guidance	<ul style="list-style-type: none"> - College degree required for accounting license. - Minimum curriculum standards not up to IES. - No entry examination - No professional experience requirement - No CPD requirement. 	Para. 41, 46, 47	Low
3	International Standards, Related Practice Statements and Other Papers Issued by the IAASB.	<ul style="list-style-type: none"> - ISA adopted in statute - No implementation regulations issued by JTC. 	Para. 60	Partial
4	IFAC Code of Ethics for Professional Accountants	Panama's code of ethics dates to 1984 and is not as comprehensive as IFAC's.	Para. 48	Low
5	International Public Sector Accounting Standards and related guidance	CGRP has a convergence product underway with local government accounting standards and IPSAS.	Para. 38	Partial
6	Investigation and Discipline	The JTC and the professional associations only investigate specific complaints, and sanctions are rare or nonexistent.	Para. 69-70	Low
7	IFRS	<ul style="list-style-type: none"> - IFRS adopted in statute - No implementing regulations issued by JTC. 	Para. 15, 57	Partial

C. PROFESSIONAL EDUCATION AND TRAINING

50. **Most Panama accounting graduates do not receive significant instruction in IFRS, ISA or other relatively recent developments.** The University of Panama (UP) has pride of place within the national university system as the country's oldest and largest university with approximately 70,000 students. The national constitution, Art. 95, gives the UP the authority and responsibility to oversee all other universities, and in particular the Law on the Accounting Profession gives it the responsibility to certify other universities' accounting programs for the purpose of conferring the accountant license. In practice, however, this oversight is not ongoing. Rather, a university applies for accreditation of each of its programs of study (at a cost of around \$5,000 per program), and upon receiving the accreditation the program can continue indefinitely as long as its purpose does not change significantly.⁶⁰ In practice, this leaves universities with little incentive to upgrade their curricula over time.⁶¹ Outdated curricula (particularly as regards international standards), coupled with the lack of academic research in accounting in Panama, have made it difficult to implement IFRS effectively.

51. **Panama has taken steps to put in place minimum education quality standards and a system of evaluation, but these steps have not yet yielded tangible results.** In 2006, a National Council of Accreditation and Evaluation (CONEAUPA) was created to strengthen the oversight and evaluation of tertiary education.⁶² This entity is not yet active, but it may lead to improved educational standards in the fields of business, accounting and auditing, among others.

52. **Two universities have a strong accounting legacy, namely the University of Panama (UP) and the Catholic University of Santa Maria la Antigua (USMA).** In addition to being the two oldest universities in Panama and among the largest, both universities have permanent seats on the JTC, the accounting licensing and standard-setting body. The UP, the largest, graduates around 300 students per year with an accounting bachelor's degree, while enrolling around 2,000 students.⁶¹ There are around a dozen other smaller universities that offer bachelor's degrees in accounting.

53. **An unusual feature of Panama's accounting education landscape is the Authorized Public Accountant Specialized University (UNESCPA).** It was created in 2004 by the *Colegio* and the local affiliates of the six largest international audit networks. The institution was set up to help address a perceived lack of high quality accounting instruction, and it is an interesting example of how international audit network affiliates can help improve the quality of the profession overall. The university offers a four-year bachelor's degree program in accounting; master's degrees in taxation, forensic auditing,

⁶⁰ "Accreditation in Latin America and the Caribbean: Panama," *World Education News and Reviews*, New York, May 2007. <http://www.wes.org/ewenr/07may/panama.htm>. Accessed 25 May 2009.

⁶¹ Alfredo Rodríguez Neira and Alfred Boronovo, "Accounting Education in Panama." Report on a *Project to Improve Accounting Education in Central America*, World Bank, 2009.

⁶² Law 30 of July 20, 2006.

corporate finance, and banking; and certificate programs in IFRS, accounting, and finance. UNESCPA enrolls approximately 250 students currently, of which 60 are candidates for the bachelor's degree. It has plans to enroll twice as many bachelor's degree candidates in the coming years. Most of UNESCPA's professors are practitioners at the international audit firms, and the university offers instruction in IFRS, ISA, corporate social responsibility, risk-based management, forensic auditing, and information technology (including audits of information systems). Members of the *Colegio* receive discounted tuition at UNESCPA.

54. **A comparative evaluation of UNESCPA's accounting and auditing curriculum described it as "one of the top [accounting] programs in the region," and the strongest in Panama.**⁶¹ UNESCPA is a private, highly specialized university—free from many of the obligations and challenges that confront larger and public universities. It is not yet self-sustaining, in that it relies on donations from the international audit firms. The demand for master's degree and certificate programs is reportedly strong, although the four-year program suffers from competition with other universities as well as the greater appeal of other career paths.⁶³

D. ACCOUNTING AND AUDITING STANDARD-SETTING

D.1 Accounting

55. **Panama has a legally constituted accounting standard-setting body, the Technical Board of Accounting (JTC), but that entity does not currently have the human and financial resources to carry out this role.** The JTC has only four paid staff members who are primarily occupied with the administrative functions of granting accountant licenses. A politically appointed Technical Secretary from the MICI presides over the body. The other six members of the JTC work on a *pro bono* basis, representing the four accounting professional associations and the accounting departments of two universities (UP and USMA). The JTC does not have its own dedicated office space, but rather shares space with other branches of the Ministry of Commerce and Industry. The JTC has only a "bare-bones" budget that covers the salaries of its staff members and their supplies. It does not have enough financial or personnel resources to carry out effective standard-setting activities.

56. **Another entity, the Financial Accounting Standards Commission (NOCOFIN) was created by the JTC and was originally the standard-setting body.** Between 1978 and 1994, NOCOFIN adopted 11 local accounting standards, which were published in the Official Gazette. After issuing its last standard in 1994, NOCOFIN went through a period of dormancy. Now, NOCOFIN has been reconstituted, but its role is not well defined. The ambiguity surrounding NOCOFIN's role in the standard-setting process could lead to conflicts of authority in the future.

⁶³ For instance, UNESCPA's Rector reported that jobs in call centers were a more attractive alternative than a four-year program of study in accounting.

57. **The fragmentation of the profession and related internal discords compound the institutional weaknesses of JTC/NOCOFIN.** In 1998 and again in 2000, the JTC issued resolutions to adopt IFRS as the generally accepted accounting principles of Panama.⁶⁴ On both occasions, these resolutions were successfully challenged in court by the MOVICOP and found to be unconstitutional by the Supreme Court on the grounds that the JTC could only recommend standards for the MICI to issue.⁶⁵ A subsequent amendment to the Law on the Accounting Profession in 2005 explicitly empowered the JTC to set and enforce accounting and auditing standards, for both businesses and professionals. The amendment also clarified NOCOFIN's role, which is to recommend regulations to the JTC for its subsequent adoption.⁶⁶ The same amendment officially adopted IFRS and ISA but directed the JTC (based on NOCOFIN's recommendations) to issue any regulations relating to IFRS and ISA adoption.⁶⁷ **To date, the JTC has not issued any regulations relating to the adoption of IFRS or ISA.**

58. **This vacuum has led the DGI to formally adopt and publish the text of IFRS, as previously mentioned (Para. 15).** On August 5, 2008, the DGI published a Spanish translation of the 2007 version of IFRS in the official Gazette, which is also published in its entirety on the Internet. Some members of the JTC feel that the DGI effectively impinged on the JTC's standard-setting authority. In any event, such dual sources of corporate financial reporting standards is problematic because of the confusion it can generate. Neither the DGI nor the JTC appears to have a robust IFRS adoption process in place, which is especially problematic since IFRS are constantly changing.

59. **By publishing a specific version of IFRS in the Gazette, the DGI has created uncertainty with respect to the binding nature of future IFRS updates.** The preamble of the DGI's resolution accompanying the 2007 IFRS publication says that the IFRS were published in the interest of the taxpayers, rather than as a necessity for these standards to be binding. Yet it is not clear when Panamanian companies must follow new or amended IFRSs—immediately after they have been approved by the IASB, or after an updated version has been published in the Gazette? The DGI and the JTC should head off any potential confusion by devising a standards endorsement process, so that it is clear to everyone at which point international standards take on the force of law in Panama.

D.2 Auditing

60. **With regard to audit standards, ISA was formally adopted in Panama through the 2005 update to the Law on the Accounting Profession. Yet the JTC has not issued any resolutions of its own regarding ISA as was contemplated in the law.** None of the four professional accounting bodies has adopted ISA for its members, as is often the practice in other countries, given that these standards were formally adopted in

⁶⁴ JTC Resolution No. 4 of February 10, 1998 and JTC Resolution No. 3 of August 30, 2000.

⁶⁵ KPMG Panama, *Normas Internacionales de Información Financiera: Su aplicación en la República de Panamá*. Panama:2005, pp. 9-12.

⁶⁶ Now reconstituted, NOCOFIN's membership consists of 22 members (five each from the four professional accounting organizations, and one member each from the accounting departments of the UP and the USMA) who serve *pro bono*. Some members of the JTC also serve on NOCOFIN.

⁶⁷ Law 6 of 2005.

statute. Again, a ratification or endorsement process should be adopted for ISA, so that auditors can be certain as to which standards they are bound to follow, and at what point updated ISAs take effect in Panama.

E. ENFORCEMENT OF ACCOUNTING AND AUDITING STANDARDS

E.1 Accounting

61. **The requirement that even medium-sized companies⁶⁸ prepare audited financial reports according to IFRS is not practicable and therefore cannot be enforced.** Although the tax authority (DGI) now requires income tax declarations to be filed according to IFRS for companies with annual revenues exceeding \$250,000, most companies and their accountants (“preparers”) are not capable of complying with this requirement (outside of some supervised sectors where IFRS is already mandatory). Moreover, significant confusion remains about inconsistencies between tax rules and IFRS.⁶⁹ Although the DGI promised in 2005 to offer free courses in IFRS for taxpayers and accountants,⁷⁰ this training has not been offered on a large scale (the existence of a number of costly IFRS trainings is further evidence that free courses are not available). Even if it wanted to, the DGI does not have enough qualified staff members to effectively enforce compliance with applicable accounting standards for more than the largest companies.⁷¹ At the time of the law’s passage in 2005, only 60% of the DGI’s auditors had received training in IFRS.⁷⁰ Yet IFRS is a complex standard that is frequently updated; even if the entire auditing staff has received some training in IFRS in the intervening period, they will have difficulty enforcing this law effectively.

62. **Regarding the banking sector, the SBP has significant enforcement capacity.** The SBP carries out both off-site and on-site inspections, and has a relatively large and well-qualified inspection staff. The on-site inspections team has carried out an average of more than 150 inspections per year, including overseas inspections.

63. **Yet the SBP has not applied any sanctions in the last three years for violations of accounting or auditing standards, pointing to a lack of interest or will to enforce these particular provisions.** Evidence of this can be found in the SBP’s Circular 31 of 2007, which reiterates that the SBP’s prudential requirements take precedence over IFRS or USGAAP. The 2007 Circular states that, “[Circular 1 of 2006] seems not to have been followed by some banks nor their external auditors.” This

⁶⁸ While there is no universal definition of what constitutes large, medium or small enterprises, the DGI’s IFRS requirement for companies with more than \$250,000 annual gross revenues clearly covers some mid-sized enterprises.

⁶⁹ IFRS is not meant to be a system for tax reporting in any case. With its large corpus of standards and complex provisions (e.g., fair-value measurement of financial instruments and hedge accounting), IFRS is probably too complex for the purposes of tax collection. European countries, for instance, use much simpler standards for legal entity financial reporting.

⁷⁰ “Taxpayers do not know how to use IFRS to file their taxes,” in *Diario La Prensa*, February 19, 2005. <http://mensual.prensa.com/mensual/contenido/2005/02/19/hoy/negocios/137694.html>.

⁷¹ As of April 2009, there were 23 members of the Audit and Oversight Department of the DGI, including 15 accountants. Source: DGI email, April 14, 2009.

accusation of widespread failure to comply with SBP regulations, without accompanying sanctions, suggests that a stronger enforcement posture with respect to financial reporting requirements may be necessary. **A related weakness is that the SBP's website does not have a separate section listing sanctions.**⁷²

64. **The SSRP's capacity to monitor compliance with accounting and auditing requirements in the insurance sector needs to be significantly strengthened.** The SSRP's Auditing Department responsible for monitoring compliance with accounting and auditing requirements has only five inspectors, which is insufficient for effective supervision of this sector. Further, although these inspectors are accountants with significant experience, they may be replaced at any time, including when the political party in power changes. This turnover of employees inhibits the development of experience and capacity that is necessary to effectively carry out monitoring and supervision of the sector. Indicative of this lack of enforcement capacity is the fact that the SSRP has never imposed sanctions on a supervised entity for inaccuracies or failure to comply with financial reporting or auditing requirements (the Law empowers the SSRP to impose fines of \$1,000 to 50,000 for failure to comply with financial reporting requirements or other regulations).⁷³

65. **Enforcement of financial reporting and auditing requirements for other non-banking financial institutions, such as lending companies (*financieras*), financial leasing companies, and savings and loans, is weak.** There does not appear to be significant supervision of these financial institutions. Rather, they are duly registered and financial information is collected primarily for statistical purposes. There are no "fit and proper" requirements on external auditors or auditor registries that could help them to ensure high-quality financial reporting. There are no sanctions of any kind published on the regulator's website.

66. **The securities market regulator, CNV, does occasionally sanction supervised entities for failure to follow applicable financial reporting standards, although most sanctions imposed are due to tardy or incomplete submission of annual or quarterly reports.** In the last three years, the CNV has not imposed sanctions for violation of accounting and auditing standards. However, investigations have been ordered into two securities houses and two auditing firms, with the intent to determine whether they have violated rules concerning accounting registers and audit. These investigations have not yet concluded.

67. **The CNV's accountants systematically review financial statements and have uncovered discrepancies in the past.** The most notable case had to do with quarterly financial statements submitted by the ADELAGE Group in 2000, prior to its eventual

⁷² Rather, these sanctions are issued and published within Resolutions, which a user must read through individually in the order they were issued. It is not possible to search for all sanctions applied to one bank, or to search by a specific type of infraction. For maximum effect, sanctions should be published in as transparent and open a manner as possible.

⁷³ E.g., for insurance companies: Law 59 of July 29, 1996, Title VII, Art. 115. The laws governing captive insurance companies and reinsurance companies have similar provisions.

bankruptcy.⁷⁴ In that case, sanctions for a total amount of \$1,050,000 were subsequently imposed against two of the Group's owners, the accountant, the comptroller, and the external auditor. The court proceedings for this case have been especially lengthy—indeed, the latest decision upholding one of the CNV's sanctions was handed down by Panama's Supreme Court in February 2009.⁷⁵ In another, less publicized, case, the CNV denied a license to a brokerage house based on substantial inconsistencies and errors in its financial statements.⁷⁶

68. **There is a mechanism for cooperation among the major regulatory agencies, however it is infrequently used.** In order to promote coordination among regulators, there is a Financial Coordination Council (CCF) that includes the Ministry of Economy and Finance, SBP, SSRP and CNV. This body meets infrequently, however—sometimes just a few times a year. In general, the various regulators reported limited coordination of their efforts.

69. **The JTC does not have any mechanisms to monitor actual accounting or auditing practices.** Although it is legally required to oversee the profession, the JTC has no professional staff to carry out this function.⁷⁷ The JTC's appointed members are (with the exception of the Technical Secretary) accountants representing their professional associations or universities, on a *pro bono* basis. The most the JTC's limited staff and financial resources allow is to respond to formal complaints, although many of these complaints arise from accountants who wish to protect the functions technically reserved to them under the law. However, given that the JTC is a profession-dominated body, there is a disincentive for it to sanction fellow members of the profession.

70. **Enforcement from the professional bodies is weak to nonexistent.** As these bodies compete with each other for members, there is little incentive for them to sanction one of their own dues-paying members for breaches of the standards of accounting and auditing practice or ethical conduct. While the bylaws of all of the professional associations refer to Honor Councils (*Tribunal de Honor*), these bodies are in effect inactive. No sanctions are posted on any of the professional associations' websites, nor in any of the newsletters published recently. None of the elected leaders of the professional bodies could cite a case of any sanction imposed by the respective Honor Council. In any case, the Honor Councils only respond to formal complaints and again function only on a *pro bono* basis. The near-universal experience with Honor Councils across the region is that they are not credible enforcement bodies.

⁷⁴ A good summary of the ADELAGE case can be found in *Economist Intelligence Unit*, "Panama finance: Prominent bankruptcy spurs new legislation," March 9, 2001.

http://www.eiu.com/index.asp?layout=VWPrintVW3&article_id=1694824569&printer=printer&rf=0
[Accessed 23 March 2009]

⁷⁵ Monica Palm, "Corte ratifica multa a Aquilino de la Guardia," *Diario La Prensa*, February 6, 2009. <http://mensual.prensa.com/mensual/contenido/2009/02/06/hoy/panorama/1685875.asp>
[Accessed 23 March 2009]

⁷⁶ CNV Resolution No. 211-07 of August 17, 2007.

⁷⁷ JTC has only four full-time, paid staff members, who are primarily occupied with processing accountant licenses. These staff members are not accountants or otherwise equipped to perform an oversight function even if they were so empowered.

E.2 Auditing

71. **The oversight of auditors in the financial sector needs strengthening.** Although the SBP reserves the right to reject an unqualified auditor (Para. 22), creating an auditor registration process is a stronger mechanism to ensure qualified auditors. A registration process puts the onus on the auditor—rather than the regulator—to demonstrate adherence to international standards, sufficient professional experience, independence, a sound quality assurance system, a system of continuing professional development for management and staff, and sector-specific knowledge. In Uruguay, the supervisors of the banking, insurance and securities sectors share a common auditor registry. Uruguay’s registry has come to be viewed more broadly as an indicator of competence and is used by other institutions as a basis for selecting auditors. In Panama, a registry could be established by the regulators as a group, ideally in cooperation with representatives of the accounting profession.

72. **In the insurance sector, auditor oversight is very weak.** Even though the SSRP requires that auditors have three years of insurance experience, it cannot approve or reject external auditors. Similar to the case with the SBP, the SSRP would benefit greatly from an auditor registration process to help ensure sufficiently qualified auditors. Furthermore, there is currently no auditor rotation requirement in the insurance sector, despite the fact that auditor rotation requirements are increasingly common—particularly in supervised sectors—as a means of promoting auditor independence.

73. **The CNV could benefit from tightened auditor oversight requirements.** Like the financial-sector regulators, the CNV lacks an auditor registration process. A related weakness is that the CNV cannot reject the appointment of external auditors it deems unqualified (only those who are not independent). Further, it is not sufficiently clear whether, in practice, the CNV is able to sanction errant external auditors. The CNV has successfully imposed sanctions on one external auditor in the past, and investigated others, however its sanctions and investigations are almost always challenged in court, which leads to a lengthy (three to four years) judicial appeals process.⁷⁸ While the CNV contends that the securities law gives it the authority to sanction external auditors, the latter are not explicitly mentioned in the law.⁷⁹ Moreover, it is not clear why the CNV has exercised this authority only once, even though it has sanctioned several companies for failing to adhere to financial reporting standards.⁸⁰ As previously discussed, the IMF

⁷⁸ The administrative tribunal of the Supreme Court upheld, in November 2005, the CNV’s sanction of \$100,000 against Arthur Andersen, originally issued in June 2001.

⁷⁹ Law 1 of July 8, 1999 (as amended by Laws 42 of 2000, 29 of 2001, 11 of 2002, 45 of 2003 and 6 of 2005). The law states that any person or company over whom a regulated entity exercises control (e.g. via contract) is subject to CNV requirements.

⁸⁰ For instance, in 2005, the CNV imposed sanctions on *Autofinanzas, S.A.* and the company’s owners for failing to follow IFRS, among other breaches. While an investigation was initiated into the company’s external auditor for issuing a clean audit opinion on these financial statements, the investigation was challenged in court and no action was taken against the external auditor. See CNV Resolution 21/03 ordering the investigation, Resolution 243/04 imposing fines on all investigated parties except the external auditor, and Resolution 131/05, formally ending the investigation against the external auditor.

has cited the CNV's lack of "explicit power over external auditors" as a shortcoming of Panama's regulatory framework (see Para 36). If indeed the CNV has the authority to sanction errant auditors, this authority should be made explicit.

74. **Neither the JTC nor any of the professional associations monitors the quality of practice among their membership, and there are no requirements for internal firm-level quality assurance processes to ensure that accounting and audit firms are meeting acceptable standards of quality.** Neither the JTC nor any of the professional associations has any mechanism to investigate or enforce compliance with ISA or any audit standard. Various stakeholders—including regulators, lenders, investors and other users—rely on the assurance of a clean audit opinion (or the questions raised by the lack thereof) in order to make decisions.⁸¹ The absence of enforcement mechanisms for sound auditing standards calls into question the reliability of these audits and, by extension, the usefulness of audited financial statements.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

A. ACCOUNTING STANDARDS AS DESIGNED

75. **Since the 2005 amendment to the Law on the Accounting Profession formally adopted IFRS, the *de jure* accounting standards in Panama for enterprises are understood to be IFRS. However, as mentioned in Para. 59, there is some ambiguity with respect to subsequent updates of IFRS.** At this point, a 2007 version of IFRS has been published in the official gazette, and is therefore the legal reporting standard for non-financial enterprises. The only way to overcome the current difficulty and eliminate any ambiguity would be for the law to set out a general endorsement of IFRS in Panama and to require from a legally empowered standard-setter (i.e., currently, the JTC) to review and endorse any subsequent changes to IFRS.

76. **Regarding banks' financial reporting, a number of differences exist between applicable accounting rules and IFRS.** As previously mentioned (Para. 21), the SBP has adopted a series of accounting provisions that conflict with, and take precedence over, IFRS. These differences relate to three main areas.⁸²

- (a) ***Determination of loan provisions.*** Under Accord 6 of 2000, these provisions are to be evaluated using a "matrix-based" approach, i.e., one that requires fixed percentages of provisions to be applied to the principal amount depending on the

⁸¹ For example, a recent report from the Basel Committee on Banking Supervision noted, "The need for bank supervisors to be confident of audit quality remains one of the keys to effective banking supervision..." Basel Committee on Banking Supervision, *External audit quality and banking supervision*, Bank for International Settlements, Basel, Switzerland: December 2008, p. 7.

⁸² A description of differences between SBP-approved accounting rules and IFRS is generally provided in the explanatory notes to the financial statements of banks, which can generally be accessed at the specific banks' websites.

number of past-due days for different categories of loans. This method is consistent with the approach by most bank supervisors in Latin America and in Spain for prudential purposes. It differs with the approach of IAS 39, *Financial Instruments: Recognition and Measurement*, which requires assessing loss provisions on the basis of estimated future cash flows by loan or group of loans. It is likely to lead to significantly different values than those that would have been determined under IFRS, although the magnitude of such differences could not be assessed.

- (b) **Valuation of securities investments** – According to Accord 7 of 2000, the SBP requires banks that hold securities to maturity to depreciate their value according to a fixed schedule if the issuer of the security suffers a deterioration in their economic solvency or if there exists a high probability of default; or if a scheduled interest or principle payment was missed by more than 90 days; or if there is no longer a liquid market for the security; or if a significant deterioration in currency, country or other risk occurs. This conflicts with IFRS, which require these investments to be valued according to amortized cost using the effective interest method.
- (c) **Valuation of property received as collateral on loans** – According to Accord 3 of 2006, property given as collateral by debtors and reclaimed from them must be written-off completely after 18 months if it has not been sold, except for property “of social interest,” valued at less than \$17,500. IAS 40, *Investment Property*, requires that these assets be valued at fair value and that a loss be recognized only if the fair value is lower than the value of the loan for which the property was collateralized.

77. The accounting standards currently in force in the insurance sector also differ from IFRS in a number of significant aspects. Based on the information provided by the SSRP, the review of the notes to the financial statements of two Panamanian insurance undertakings, and an article published by a leading audit firm in Panama,⁸³ the main areas of discrepancy with IFRS in the insurance sector are the following: (a) the valuation of insurance liabilities, and the lack of a liability-adequacy test, which is required by IFRS 4, *Insurance Contracts*; (b) the valuation of financial instruments and the fact that embedded derivatives in insurance contracts are not recognized under SSRP accounting rules; (c) the recognition of deferred taxation, which is required under IFRS but not by SSRP; (d) a much lower level of disclosure than under IFRS; and (e) the netting of several types of insurance policy-related assets and liabilities which is permitted under SSRP rules. Considering the above discrepancies, the financial statements of Panamanian insurance undertakings would most likely portray their financial position much differently if they were prepared in accordance with IFRS.

⁸³ “Las Normas Internacionales de Información Financiera y las Prácticas Contables de Seguros en Panamá”, Hector Castillo, KPMG Panama, SSRP Magazine, April 2006. The situation described in this article has not changed significantly since then.

78. **A review of 21 sets of corporate financial statements as of December 31, 2007 or 2006 was carried out as part of this ROSC, consistent with the approved methodology.** All entities included in the sample were public-interest entities (PIEs) due to the fact that the financial statements of closely-held entities incorporated in Panama are not published. The sample included 5 banks (following SBP rules), two insurance undertakings (following SSRP rules), two state-owned enterprises (IFRS) and 12 listed, non-financial companies (IFRS except for one set of financial statements that included a reference to “Panamanian GAAP”).

79. **Overall, the review of the financial statements of the 12 listed enterprises showed a high level of observance of IFRS, even though the instances of non-compliance it revealed call for a more robust enforcement regime.** As should be expected given the nature of the review, instances of non-compliance identified had to do mainly with insufficient or inadequate disclosures. In addition, a number of issues relating to the valuation of assets were also uncovered. Another issue noted had to do with the fact that the date of issue of financial statements was omitted in three cases. Due to the fact that the sample of financial statements reviewed only included public-interest entities, the conclusions drawn from the review cannot be extended to the financial reporting of closely-held companies, which is likely to be of lesser quality because these entities are subject to much more lax oversight.

B. OBSERVED REPORTING PRACTICES

80. **One of the areas of departures from IFRS identified by the review involved the valuation of financial assets and the use of fair value.** The review noted several instances where financial assets were carried at cost. In two cases, the notes failed to provide adequate justification for such treatment, especially why the assets were not stated at fair value. In one case the notes mentioned that fair value had not been estimated, without further explanation. Fair value is still considered a more adequate method of measurement than historical cost, because it provides a more current—and therefore relevant—value. In addition, even under the historical-cost method, for most investments (held-to-maturity bonds being a significant exception) it is necessary to estimate fair value because, if such value is lower than cost, a loss must be recognized.

81. **Issues relating to the lack of disclosure included the following:**

- a. ***Related-party relationships and transactions.*** While most companies made some disclosures of their relationships and transactions with related parties, these were often incomplete, with information lacking on the nature of the transactions, volumes, prices and amounts involved. Companies are naturally reluctant to fully disclose that information because they consider it sensitive, but full disclosure is needed to ensure that the interests of investors, especially minority shareholders, are protected.
- b. ***Details of key captions of the financial statements.*** The notes to the financial statements should include appropriate details and explanations for the user of the financial statements to gain a proper understanding of the solvency and

profitability of the company. The review identified a number of instances where details were missing. This applied in particular to revenues, income tax, bad debt reserves, “other” assets, and accounts payable.

- c. **Description of accounting policies.** The description of significant accounting policies as required by IAS 1 included many generic principles that are required by IFRS but omitted aspects specific to the respective company. For instance, key assumptions used for estimating employee benefits were often omitted.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

82. **ISA has been formally adopted in Panama for all financial statement audits.**⁸⁴ Companies with capital exceeding \$100,000 or with an annual sales volume greater than \$50,000 are subject to a mandatory annual statutory audit under the tax code (Para 14).

83. **The review of financial statements carried out as part of this ROSC (Para. 78) raises a number of issues regarding compliance with ISA by the respective auditors.** The reports reviewed had been issued by nine different audit firms including the affiliates of the four largest international audit networks (“Big 4”). First, it was obvious that it was the auditors, not the company itself, who had prepared the notes to the financial statements, which is still commonplace in many countries but clearly breaches the auditors’ independence as it leads to a self-review situation. In several cases the wording of the audit report did not strictly follow ISA 700, *The Independent Auditor’s Report on a Complete Set of Financial Statements* or ISA 701, *Modifications to the Independent Auditor’s Report Auditors*. One of the fundamental principles of ISA is the need for standardization and consistency in the wording of audit reports to ensure they are easily, clearly and unambiguously understood. Using non-standard and sometimes ambiguous language leaves room for doubt and confusion among the users of audited financial statements. Other specific issues of concern relating to audit reports included the following: (a) a number of entities had high levels of indebtedness and low current ratios (current asserts over current liabilities), yet in none of these cases did the auditor include a mention in its report regarding the risk this represent for the ability of the audited entity to continue as a going concern; (b) one audit report including several scope limitations (i.e., indicating that certain areas could not be verified by the auditor), yet the opinion did not include any qualification (“except for the effect, if any,...”) and (c) in several cases, the reporting basis was described as a mix of IFRS and prudential rules (IFRS as adopted by the SBP).

⁸⁴ Through the 2005 update to the Law on the Accounting Profession (Law 6 of 2005).

84. **Adherence to ISA by Panamanian audit firms, especially small and medium-sized ones, is hampered by weak oversight of the statutory audit function.** A workshop was held in the *Colegio's* premises convening members of the *Colegio* and of the three other associations to discuss auditing practices in Panama among other issues relevant to this ROSC. Several issues were raised during the discussion pointing to the need to improve current practice. For instance, several participants mentioned as a weakness the lack of audit guidance especially in terms of using professional judgment, working papers, the pricing of audit fees and, perhaps more importantly, the lack of quality assurance to ensure compliance with ISA and the IFAC Code. Participants also pointed to the need to significantly improve accounting education to ensure that audit practitioners are adequately prepared.

V. PERCEPTIONS ON THE QUALITY OF CORPORATE FINANCIAL REPORTING

85. **The demand for high-quality corporate financial reporting in Panama is relatively strong, especially since banks are required to obtain financial statements from borrowers before conceding credit.**⁸⁵ These financial statements are customarily audited, but not always. Lenders reported that, in general, larger companies' financial statements are more likely to be audited than those of SMEs.

86. **Lenders expressed more confidence in financial statements from banks, listed companies, and larger companies, although they noted a few high-profile cases of fraud among listed companies despite clean audit opinions.** Lenders also reported that SMEs (when they have audited financial statements) are typically audited by individuals or small firms, and that these financial statements might be less reliable.

87. **Perceptions of the accounting and auditing profession within the business community are mixed at best.** Based on panel discussions and interviews with lending institutions, business executives and regulators, there are doubts about the ability of Panama's accountants to apply IFRS, especially those working in small firms or sole proprietorships. Several felt that the accountant qualification needed to be strengthened through a mandatory accounting examination or other measures. Others noted the divisions within the accounting profession and felt that this fragmentation was a drag on the respectability and prestige of the profession. For example, one interviewee noted simply that "accountants don't end up directing banks or listed companies."

88. **With respect to auditing, 7-10 auditing firms are generally deemed more reliable, in addition to the "Big 4".** Indeed, several lenders complained that this perceived lack of qualified audit firms frequently led to delays in issuing audited financial statements. Companies frequently are unable to issue audited financial statements until six months after the close of their fiscal year because the larger, more

⁸⁵ SBP Accord 6 of 2000.

reputable audit firms do not have enough staff to keep up with the demand for their services.

VI. RECOMMENDATIONS

89. **Detailed recommendations will be developed in consultation with the Panamanian authorities and in-country stakeholders during a workshop to be held in Panama City.** Instead of including fairly prescriptive recommendations in the draft ROSC report as is usual for this type of diagnostic, the approach used in this case has been to incorporate as many inputs as possible from the national authorities and the local private sector and only suggest a framework for solving the identified issues. By asking the Panamanian stakeholders to develop the details of the country action plan, we hope to enhance country ownership of this program and thus the likely impact of this ROSC. A country action plan is expected to be developed under the aegis of the Ministry of Economy and Finance (MEF), possibly with the assistance of the World Bank and other development partners. The action plan will involve government policies as well as capacity development initiatives for the accounting profession and, to a lesser extent, the regulatory agencies. If possible, it will be included in the final version of this report.

90. **The following principles should underpin the authorities' and profession's efforts to reform and strengthen Panama's corporate financial reporting:**

- (a) ***Simplifying accounting and auditing obligations*** whenever possible, especially for SMEs, to reduce the cost of doing business in Panama for modest-sized businesses. Accounting/audit obligations should be reasonably justified in terms of public policy objectives;
- (b) ***Strengthening existing mechanisms*** to the extent that they are conceptually sound and sustainable, rather than seeking a complete overhaul of existing mechanisms;
- (c) ***Consolidating the institutional framework*** in order to (i) eliminate duplication of efforts, (ii) avoid multiple requirements that may conflict on issues and cause confusion and (iii) foster synergy between regulatory agencies for maximum and best results; and
- (d) ***Adopting international standards*** whenever practicable, as opposed to developing custom-made solutions that are costly and difficult to maintain, and which do not convey the same level of confidence as international ones. Custom-made solutions can represent an added cost of doing business for foreign investors and domestic enterprises that are used to conducting business internationally.

91. **The Tax Code and DGI Regulations should be amended to adapt the thresholds for statutory audit and IFRS requirements in such a way that SMEs are not subject to unduly onerous obligations.** The levels at which the current limits are set (Paras. 14 and 15) impose an unrealistic burden on relatively small entities. Moreover, the supply of IFRS-trained accountants is not sufficient to meet the demand even if companies were to comply fully with the law. Increased threshold amounts could be defined after thorough consultation with the private sector, banks, the accounting profession and other stakeholders.

92. **Furthermore, there is a need for a simplified accounting and financial reporting framework for SMEs and other private entities**, setting requirements commensurate with their size, types of transactions, and more limited range of stakeholders. A simplified set of standards will make it easier for SMEs to improve the quality of their financial information and, ultimately, to use that information to access credit. The IASB is poised to issue a new set of financial reporting standards for reporting by private entities (“IFRS for Private Entities”). These simplified standards, which are at a near-final stage and are expected to be released in the third quarter of 2009, would require a lesser level of disclosure and eliminate the most complex options provided in IFRS, especially those requiring the use of fair values. **The Panamanian authorities should adopt these standards once officially released for use by local private entities.**

93. **Although it is currently optional for companies to file their financial statements with the public register (Para. 18), Panama should consider making it mandatory.** This requirement, common in Europe, would add beneficial transparency without significant added costs to the companies. Publicly available financial statements are useful for the development of credit bureaus, and can facilitate cross-sectoral analysis by financial institutions and other users. Moreover, when the law allows companies to limit their liability to the assets of the company, these companies have an obligation to the public and their creditors to be transparent about the extent of these assets. A few other small Latin American countries have mandatory companies registries, and their examples are instructive. In Uruguay, all commercial companies with assets in excess of US\$320,000 or revenues in excess 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 financial statements must be “certified” by a professional accountant, although not audited. Any third party can obtain copies of the financial statements for the last three fiscal years from the REC, for a fee equivalent to approximately US\$10.⁸⁶ In El Salvador, the Code of Commerce requires that non-listed enterprises file their annual balance sheet with the government-administered Commercial Registry (*Registro de Comercio*). There, the public can have access to this information through the National Registration Center.⁸⁷

94. **State-owned enterprises should be subject to mandatory external audits, carried out according to ISA, and the results from these audits should be published.** Currently, some but not all state-owned enterprises already undergo external audits; it is a good practice that should be universal.

95. **Until such time as the JTC can establish a credible professional certification process and a strong auditor oversight function (Para 98 and 99), the major regulatory bodies (including at least the SBP, SSRP, and CNV) should consider strengthening their oversight of external auditors by establishing a joint auditor registration process.** Only registered auditors that meet minimum qualifications would

⁸⁶ World Bank, ROSC Accounting & Auditing, Uruguay, January 2006.
http://www.worldbank.org/ifa/rosc_aa_ugy.pdf

⁸⁷ World Bank, ROSC Accounting & Auditing, El Salvador, June 2005.
http://www.worldbank.org/ifa/rosc_aa_elsalvador.pdf

be allowed to perform audits of regulated entities. An auditor registration process should focus on adherence to international standards, sufficient professional experience, independence, a sound quality assurance system, a system of continuing professional development for management and staff, and sector-specific knowledge. If practicable, it should include some representation from the audit profession in designing the minimum qualifications. As previously mentioned, similar mechanisms have been established in Uruguay, Brazil and Mexico, which could serve as models.

96. **The JTC should adopt IFAC's Code of Ethics.** The IFAC Code is not only more comprehensive than the JTC's 1984 Code currently in force, but it also carries more legitimacy and recognition on an international level. There is no clear benefit for Panama of maintaining its own accountant code of ethics.

97. **The JTC should mandate continuing professional development (CPD) for all licensed accountants.** The International Education Standards for Professional Accountants recommend a minimum of 120 hours over a three-year period. No profession can achieve competence and credibility without requiring continuing education from its membership and enforcing those requirements.

98. **The JTC should be strengthened in a number of ways,**⁸⁸ including:

- It should be allotted a minimum technical staff and resources to carry out the functions of an independent standard-setter and audit oversight body. Currently, the JTC performs some but not all of these functions. Its role in registering qualified accountants and in standard-setting should be strengthened and expanded to include licensing of statutory auditors, enforcement of professional standards, audit quality assurance, and reporting to the public;
- It should be given a clear mandate to lead the accounting/audit profession toward compliance with IFAC's Statements of Membership Obligations (SMOs), which are essentially statements of international good practices;
- It should be made more multidisciplinary, to include representatives from MEF, MICI, DGI, various regulatory authorities, the business community, the profession and academics;
- Its membership and voting should be configured so that it is not dominated by the accounting/audit profession, which would be consistent with its public interest mandate and the current international trend toward standard-setting and oversight bodies independent from the profession they regulate; and
- The bodies that can designate someone to sit on the JTC should be re-evaluated. Some have proposed to require a minimum number of members in order for professional associations to be represented on the JTC, which might in effect exclude some of the existing members of JTC.

⁸⁸ Actions to strengthen JTC could involve the NOCOFIN, since the latter is placed under the authority of JTC. A decision will have to be taken regarding the appropriateness of maintaining a separate body for accounting standard-setting. Such decision does not affect the validity of the areas for improvements listed below.

99. **In the intermediate term, the strengthened JTC should aim to develop and implement a professional certification process similar, for instance, to the one administered by the Mexican Institute of Public Accountants (IMCP).** The Mexican *Contador Público Certificado* (CPC) accreditation is broadly comparable to other internationally recognized accounting licenses; the Mexican licensee can practice accountancy in the US and Canada, subject to passing examinations on national legislation and standards, in accordance with provisions of the Professional Mutual Recognition Agreement signed in 2002. If Panama's accountants were to create a comparable certification, it would contribute to Panama's integration with North America and possibly other large overseas markets.

100. **The four professional accounting bodies may wish to consider pursuing a course toward consolidation.** Given the limitations on human and financial resources, the existence of four competing professional bodies appears unsustainable in the long run. Further, the lack of resources makes it difficult for any of the professional bodies to operate to its full potential. Merging two or more of these organizations may better serve the interests of the accounting profession as a whole.

101. **Country authorities should plan a gradual, structured, and collaborative transition to IFRS for public interest entities (PIEs).** This process should include the DGI, the MICI, the JTC, the CNV, and perhaps other regulators such as the SBP, the SSRP, and others. This process could follow the Chilean model⁸⁹, and would include significant capacity-building efforts for preparers, auditors, and regulators.

102. **Panama should adopt a clear standard-setting/endorsement process for IFRS and ISA,** similar in outline to the one employed by the EU. In this way, when international standard-setting bodies such as the IASB or the IAASB update or add to IFRS or ISA, it would be clear when these updates attain the force of law in Panama.

103. **Strengthen inter-agency coordination for the supervision of PIEs.** A first step would be to convene more regular and frequent meetings of the CCF, which currently meets irregularly. The CCF may wish to consider adopting a registry of approved auditors for the statutory audits of PIEs. In the long run, a strengthened, well-functioning JTC could be delegated the responsibility for pre-qualifying auditors and audit firms for this registry, through measures such as a qualifying exam, minimum experience requirements, mandatory CPD and approval of quality assurance practices within audit firms.

104. **Regulators of PIEs should post all sanctions in a transparent way on their websites.** The CNV already posts its sanctions transparently, but its practice could be improved upon by including more information about the violation, including the legal basis of the violation and the justification of the severity of the sanction. Other countries

⁸⁹ Superintendency of Securities and Insurance of Chile (SVS), *IFRS Update*, http://www.svs.cl/sitio/mercados/ifrs_aldia.php?mercado=S [Accessed 28 March 2009].

also post their sanctions in a searchable format online, so that users can search by company, by economic sector, and by date.