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Costa Rica: A Review of Corporate Financial Reporting Practices

Report on the Observance of Standards and Codes (ROSC): Accounting and Auditing

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Main Abbreviations and Acronyms

BNV	<i>Bolsa Nacional de Valores</i> (Costa Rica National Stock Exchange)
CBCR	<i>Banco Central de Costa Rica</i> (Central Bank of Costa Rica)
CCPA	<i>Colegio de Contadores Públicos de Costa Rica</i> (Public Accountants' Professional Accountancy Organization)
CCPR	<i>Colegio de Contadores Privados de Costa Rica</i> (Private Accountants' Professional Accountancy Organization)
CGR	<i>Contraloría General de la República</i> (Office of the Comptroller General)
CONASSIF	<i>Consejo Nacional de Supervisión del Sistema Financiero</i> (Council of Regulatory Agencies)
CP	<i>Contador Público Autorizado</i> (Authorized Public Accountant)
CPD	Continuing professional development
DGCN	<i>Dirección General de Contabilidad Nacional</i> (General Accountant Office)
DGT	<i>Dirección General de Tributación</i> (Tax Administration Agency)
FTA	Free trade agreement
GAAP / GAAS	Generally Accepted Accounting Principles / Auditing Standards
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
ICE	<i>Instituto Costarricense de Electricidad</i> (Costa Rican Electricity Company)
IFAC	International Federation of Accountants
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
MoF	Ministry of Finance
NBFI	Non-banking financial institutions
PA	Private Accountant
PROCOMER	Trade Promotion Organization
PIE	Public Interest Entities
PPP	Public Private Partnership
ROSC A& A	Report on the Observance of Standards and Codes, Accounting and Auditing
SINAE	National Higher Education Evaluation System
SUGEF	<i>Superintendencia General de Entidades Financiera</i> (Superintendency of Banks)
SUGEVAL	<i>Superintendencia General de Valores</i> (Stock Market Superintendency)
SUPEN	<i>Superintendencia de Pensiones</i> (Pension Superintendency)
SUGESE	<i>Superintendencia General de Seguros</i> (Insurance Sector Superintendency)
SME	Small and medium enterprise
SMO	Statement of Membership Obligations
SOE	State-owned enterprise
UCR	University of Costa Rica

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The global financial community considers that the adoption and implementation of internationally recognized standards and codes provides a framework to strengthen domestic institutions, address potential vulnerabilities, and improve transparency with respect to the economic health of a country. The Reports on Observance of Standards and Codes, Accounting & Auditing Review, (ROSC A&A) is 1 of 12 modules developed jointly by the World Bank and IMF after the 1997 Asian financial crisis to strengthen the international financial architecture.¹ ROSCs, thus, aim to enhance countries' resilience to economic shocks and to better support their risk assessment and investment decisions.

¹ The 12 ROSC modules are monetary and financial policy transparency; fiscal policy transparency; data dissemination; banking supervision; securities regulation; insurance supervision; crisis resolution and deposit insurance; insolvency; corporate governance; accounting and auditing; payment, clearing and settlement; and market integrity.

Executive Summary

1. This Report on Observance of Standards and Codes: Accounting and Auditing (ROSC A&A) analyzes corporate sector accounting, financial reporting, and auditing practices in Costa Rica. It examines the country's accounting and auditing standards and practices vis-à-vis global benchmarks, and draws on international experience and good practices.

2. Enhancing the financial reporting framework is a cornerstone of a properly functioning market economy and a robust financial system. This ROSC A&A supports two main development objectives: (i) making Costa Rica's business environment more conducive to private investment, and (ii) advancing governance and financial accountability in both the private and public sectors.

3. Improving the quality of corporate reporting in Costa Rica will have a significant impact, including by:

- ***facilitating foreign investment and mobilizing domestic savings.*** Credible financial information helps build investor confidence, and facilitates economic integration, both regionally and globally;
- ***facilitating the growth and development of small and medium enterprises (SMEs).*** High quality financial information helps facilitate access to credit (reducing the need for collateral-based lending), and supports business planning and growth; and
- ***improving transparency and accountability on the use of public funds in state-owned enterprises (SOEs).*** The provision of high quality financial information allows the Government and citizens to monitor SOEs' financial position, and reduce the fiscal risk associated with SOEs.

4. ***Key Findings:*** Costa Rica has a number of elements in place which provide the foundations for a good-quality financial reporting environment. It is moving in the right direction with regard to accounting and auditing standards and practices, and generally rates well vis-à-vis other Central American countries. Further measures are needed to make this system fully functional and to implement accepted international standards. Key findings are outlined below:

- ***Financial reporting requirements for regulated entities are well established.*** Requirements for regulated entities (which include listed companies and most financial sector institutions) include annual audited financial statements, periodic unaudited financial statements, external audit, specified auditor selection criteria, development of a corporate governance code, establishment of audit committees, and disclosure of audited financial statements. These are in line with good international practices. While some differentiation may be reasonable in order to

respond to particular characteristics of each sector, there is scope to harmonize the requirements and deadlines which are currently set by the different regulators. Notably lacking is any requirement for “large” non-listed companies (however they may be defined) to prepare and/or file audited financial reports in accordance with stipulated standards.

- ***The financial reporting framework for state-owned enterprises (SOEs) could be improved.*** A significant improvement has already been put in place through the requirement that all SOEs apply *International Financial Reporting Standards* (IFRS) beginning in 2014. To accompany this advance in terms of financial reporting, there is a need for a formal requirement for all SOEs to be audited. Although in practice, most SOE’s financial statements are audited (by private audit firms), the audit reports are typically not made public, nor are they submitted to the Government.¹ The exception is the case of regulated SOEs, whose audit reports are published in accordance with the requirements applicable to all regulated entities.
- ***A reasonable institutional framework for accounting and auditing of regulated entities is in place.*** Banking, insurance, pension funds and the securities market are regulated under a harmonized framework, coordinated by the *Consejo Nacional de Supervision del Sistema Financiero* (CONASSIF). This coordinated structure is a good move; there is, however, scope to improve this, particularly to enable more rigorous oversight with respect to accounting and auditing.
- ***Costa Rica has taken positive steps to align with international accounting and auditing standards.*** Regulated entities are required to apply IFRS; and state-owned enterprises (SOEs) are required to do so from 2014. The professional accountancy body, *Colegio de Contadores Públicos de Costa Rica* (CCPA), has adopted the *International Standards of Auditing* (ISA). This is an advance compared to many others countries in the world.
- ***In practice, there are substantial gaps in the application of the international accounting and auditing standards which affects the reliability and comparability of financial statements.***
 - Regulated financial sector entities are required to follow IFRS, but apply versions that differ from the most current ones. There is no automatic process to adopt new IFRS pronouncements and ad hoc processes result in lags in the implementation of new standards. In addition, some regulatory requirements do not fully conform with current IFRS as a result of the incorporation of prudential requirements for certain entities in the financial sector.

¹ SOE’s financial information is consolidated at the Accounting Office (Dirección de Contabilidad). However this consolidation is performed under specific format that is not reconciled with SOE’s audited financial statements.

- The lack of capacity in the accountancy profession is another major limiting factor.
- There is need for strengthened enforcement by both the professional accountancy organizations and regulators.
- The accountancy body for accounting technicians, the *Colegio de Contadores Privados de Costa Rica* (CCPR), has yet to promote the application of IFRS. (e) The review of a sample of audited financial statements noted a number of departures from international standards (IFRS and ISA). This situation is an obstacle to comparability and reliability of accounting information, and makes it confusing for the end-users of financial statements. It also hampers the confidence of investors and other parties interested in the financial statements of various entities.
- ***The professional accountancy bodies (CCPA and CCPR) need capacity support to enhance their effectiveness.*** The professional accountancy bodies have a sizeable membership. Areas of improvement include more rigorous entry requirements for becoming a professional accountant, adhering to continuing professional development requirements, updating the Code of Ethics, better regulation over members, training of its members, facilitation of access to relevant material/documents including Spanish translations, and enforcement of audit quality. CCPA could also play a more significant role in the standard-setting process.
- ***Perceptions of the accounting and auditing profession within the business community are mixed.*** Lending institutions, business executives, and regulators consider that financial information audited by reputable audit firms are reliable, while other published information are far less reliable as a source of credible information. This can also be seen in that bank loans in Costa Rica are usually extended only with collateral or based on a company's reputation. Some observers point to the institutional divisions within the accountancy profession as a drag on its development. This constraint is combined with a high level of confidentiality for accounting records and financial reporting (except for regulated entities), in accordance with the Commercial Code, which limits transparency.

5. ***Recommendations:*** Sustainable improvements and successful reforms require addressing all key aspects of a strong corporate financial reporting framework, from sound laws to adequate education systems to robust enforcement. Policy recommendations to underpin efforts to reform and strengthen Costa Rica's corporate financial reporting, emerging from the review of corporate financial practices in Costa Rica as well as the valuable inputs received from stakeholders, are outlined below:

- ***Fully align accounting and auditing standards in Costa Rica with international standards, with appropriate differentiation for small and medium enterprises (SMEs).*** The report highlights three areas: (a) aligning financial reporting standards with the current IFRS, and having an automatic process to adopt new

IFRS pronouncements; (b) establishing a clear single standard-setting process/institution; and (c) ensuring that the full range of public interest entities (including listed companies, financial sector institutions, and large companies) prepare audited financial statements in accordance with appropriate standards. Appropriate differentiation should be made for SMEs to ensure that accounting and audit requirements are not burdensome.

- ***Develop the capacity of regulators.*** To ensure effective enforcement, regulatory agencies need to have adequate capacity, necessary authority, and independence.
- ***Strengthen the professional accountancy organizations (CCPA and CCPR) through capacity building efforts.*** CCPA needs to develop further to be able to play its role as an effective regulator of the accountancy profession, and to provide necessary support and training for its members. Ensuring compliance with IFAC's Statements of Membership Obligation (SMOs) requirements is a priority; these also provide CCPA and CCPR with a good framework to formulate their capacity development plans.
- ***Upgrade accountancy education and training.*** The professional accountancy organizations (CCPA and CCPR) need to enhance their entry and continuing education requirements and practices. One option is to work with other Central American countries toward a common professional accountancy qualification, which also takes into account country-specific aspects. An organized effort to upgrade accountancy-related education in universities and colleges is another priority.
- ***Establish an independent audit quality review program.*** This could be done through a collaboration arrangement among the various regulatory bodies and the CCPA. There should also be an efficient and effective mechanism to deal with noncompliance.
- ***Modernize the legal framework for corporate financial reporting.*** This could be done through a unique financial reporting law to replace the current fragmented framework. The law would cover aspects relating to standards-setting, adoption and implementation of appropriate financial reporting and auditing standards, disclosure, enforcement, requirements for professional accountancy organizations and their members, and audit quality assurance.
- ***Requiring statutory external audits for state-owned enterprises (SOEs) and publication of their audited financial statements.***

6. A country action plan is expected to be developed under the aegis of the Ministry of Finance. The action plan will focus on government policies, and capacity development of the accountancy profession and regulatory agencies.

I. COUNTRY CONTEXT

1. **This review of corporate sector accounting and audit practices in Costa Rica 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 corporate financial reporting practices; using a comparison of the country's accounting and auditing standards and practices vis-à-vis two global benchmarks, the International Financial Reporting Standards (IFRS)¹ and International Standards on Auditing (ISA).² This review does not cover government accounting standards and practices and corresponding auditing issues.³

2. **Costa Rica is an upper-middle income country with a population of 4.6 million and per capita GDP of \$6,550 (2010).**⁴ The country's economy is diversified and has a record of sustained economic growth enabled by political stability, strong institutions, and an open export-driven focus. Current projections estimate GDP growth to be between 4-4.5 percent over 2011-2015, driven by robust private consumption and domestic investment growth. Macroeconomic policy is oriented toward containing inflation, while facilitating growth and poverty reduction. Economic growth and proactive social policies have yielded one of the lowest poverty rates in Latin America.

3. **Costa Rica has benefited from a long-standing, stable democracy buttressed by a strong system of constitutional checks and balances.** The country abolished its military in 1949, and its strong democratic tradition relies on a system of gradual consensus building and institutional accountability. Costa Rica has maintained a determined outward strategy for growth. In addition to the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA) and the Association Agreement with the EU (whose negotiations were concluded in May 2010), the country has also negotiated several bilateral free trade agreements (e.g., with Canada, Chile, and China). This environment of stability and reliance on an open economy has attracted foreign direct investment (FDI) in high value added sectors (e.g., electronics, medical equipment) and significant tourism.

4. **The international financial community has a positive outlook,** with Moody's upgrading Costa Rica's sovereign credit rating to lower investment-grade (Baa3), Fitch assigning a non-investment grade speculative rating (BB), and Standard and Poor's also rating the country as BB.

¹ 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.

² ISAs are issued by the International Auditing and Assurance Standards Board, an independent standard-setting board supported by the International Federation of Accountants (IFAC).

³ These matters were reviewed under the Costa Rica Public Expenditure Management and Financial Accountability (PEFA) Review conducted jointly by the World Bank and the Inter-American Development Bank. Available at Costa Rica's Ministry of Finance website: <https://www.hacienda.go.cr/msib21/Espanol/Tesoreria+Nacional/InformePEFA2010.htm>

⁴ World Bank, World Data Indicators. Unless otherwise specified, the currency of designation is the U.S. dollar.

5. **The 2011-14 National Development Plan⁵ aims to improve productivity and growth through strengthening human capital and innovation, improving infrastructure, and fostering international business relationships and a more attractive investment climate.** Significant investments are envisioned in infrastructure, transport, and telecommunications. Given the sizable investments required to address aging infrastructure and the tight fiscal situation, government investments will be complemented by the private sector and FDI. To this end, the Government is actively seeking to create the institutional conditions to engage the private sector in the financing and management of infrastructure projects. The Government has begun to open some public sector-dominated industries, such as insurance, electricity, and telecommunications, to the private sector.

6. **Companies established in Costa Rica attracted by export incentives have started to provide accounting and financial services and business process outsourcing to international companies based outside Costa Rica.** In 2010, “*zona franca*” contribution to services exports has been 1.36 billion dollars, 31% of total services exports. Companies such as Hewlett Packard and Intel provide financial and accounting services to international clients using local accountancy professionals. This sector is growing and attracting young professionals, placing it in competition with audit firms for recent graduates of the best universities.

7. **These efforts to enhance competitiveness are supported by the World Bank as one of the Country Partnership Strategy (CPS) Pillars.** The CPS for FY12-15 includes supporting Government efforts to improve the quality of the business environment. IFC has pledged to support competitive companies that might realistically become industry leaders through regional expansion.

Financial Sector

8. **The World Bank CPS notes that the financial sector in Costa Rica is generally considered sound and has weathered the global crisis well.**

- The financial sector has 16 banks operating locally, with \$23.3 billion in assets (see Tables 1 and 2). Of these, four are state-owned banks with assets representing approximately 57 percent (\$15.3 billion) of total financial sector assets. The banking sector is dominated by three state-owned banks, which control close to 60 percent of total assets and are responsible for close to 60 percent of the banking sector’s total credit portfolio.
- The insurance sector was recently opened to private competition, as required under DR-CAFTA. Until 2009, the state-owned National Insurance Institute (INS) had a monopoly over the sector. Although it continues to be the dominant insurer in Costa Rica, seven other insurance companies have been registered to operate in the country.

⁵ Plan Nacional de Desarrollo, Ministerio de Planificación Nacional y Política Económica, December 2010.

- The pension funds sector is partially privatized, with eight private pension funds whose total assets as of the end of 2010 approximate \$66 million. Five state-owned entities account for 73 percent of total assets of the pension funds sector.
- The financial sector also includes: (i) 31 cooperatives and other financial institutions, such as mutual companies (*Mutuales*), and the National Teachers Association Fund.

Table 1: Assets of the Financial Sector by Group (December 2010)			
	Millions of Colones	US \$ equivalent Billions	% Share
State Owned Banks	7,779,572	15.327	57%
Private Banks	4,066,670	8.012	30%
Cooperatives	1,124,916	2.216	8%
Housing Sector	657,421	1.295	5%
Financial Companies	111,781	.220	1%
Money Exchange	1,752	.003	0.1%
Total	13,742,112	27.074	100

Source: SUGEF Annual Report 2010.

9. **Banking, insurance, securities market, and pension funds are regulated by separate bodies under an overall harmonized financial reporting framework.** These are coordinated by the National Supervisory Council for the Financial System (*Consejo Nacional de Supervision del Sistema Financiero*, or CONASSIF).⁶ CONASSIF is also responsible for providing direction for policies related to the financial sector, and for overseeing the activities of the subsector regulators. It is a high-level coordinating body of otherwise separate regulatory bodies. CONASSIF lacks substantial expertise in international accounting and auditing standards, and as such does not appear to have the capacity for rigorous oversight over the regulators with respect to accounting and auditing. However, the regulated entities are subject to a legal framework that requires the use of IFRS for accounting purposes, with some deviations arising from prudential requirements. The prudential norms are considered necessary to deal with the risks assumed by the regulated entities.

⁶ CONASSIF was created under Article 171 of the Law on the Regulation of the Securities Market 7732, December 17, 1997.

Table 2: Financial Sector Supervision in Costa Rica			
Sector/type of entity	Number of entities	Total assets US\$ bn	Oversight agency
Banking (1)	16	23.3	SUGEF
Securities	44	1.3 ⁷	SUGEVAL
Insurance	8	2.3	SUGESE
Pension funds	8	0.8	SUGEP

(1) The information refers only to banks. Detailed financial sector information is included in Table 1.

10. **The securities market is quite underdeveloped, although it is gradually expanding.** The market for medium and long-term financing is small, and local long-term financing is dominated by the public sector. There is one stock exchange in the country, the Bolsa Nacional de Valores (BNV). There are 44 issuers on the stock exchange, just over half of which are from the public sector. Public sector debt instruments accounted for 87 percent of the total volume traded. Less than one percent of the total volume traded in private sector securities was in equity shares. Initial public offerings (IPOs) are rare; there have been no IPOs since 2007.

State-owned Enterprises (SOEs)

11. **SOEs have a significant presence in both financial and non-financial sectors in Costa Rica.**

- As noted earlier, state-owned banks have a significant presence in Costa Rica's banking, insurance and pension sectors.
- Non-financial SOEs have a strong presence in Costa Rica's economy as well. There are significant numbers of state-owned enterprises (SOEs) in important sectors, including telecommunications and internet services (Grupo ICE), energy (CNFL), postal (Correos de Costa Rica), radio and television (SINART), oil refinery (RECOPE), and others.
- The governance structure varies among enterprises and the SOEs respond directly to the Government Council (*Consejo de Gobierno*) without any other formal accountability mechanism (besides the *Contraloría General de la República* -- CGR) with regard to financial control.

⁷ Number of traded companies and their value in the stock market as of December 2010.

Table 3: State-Owned Enterprises, Annual Revenues, 2009			
Name	Millions of Colones	USD billion equivalent	% of GDP
Non Financial SOEs	3,508,745	7.017	20.3%
Financial Sector SOEs	2,457,513	4.915	14.2%
TOTAL	5,966,258	11.932	34.6%

Source: CGR, “Presupuestos Públicos 2011, Situación y perspectivas,” February 2011.

This ROSC A&A aims to strengthen the quality of Costa Rica’s financial reporting, to allow the country to further attract private investment and strengthen its competitiveness.

II. INSTITUTIONAL FRAMEWORK FOR CORPORATE ACCOUNTING AND AUDITING

A. STATUTORY FRAMEWORK

12. **The Commercial Code defines the forms a company⁸ may take and provides their basic legal framework; it also sets forth a few provisions on accounting and internal controls.** The most common legal form is the corporation (*Sociedad Anónima* or S.A.), which represents 90 percent of all registered businesses in Costa Rica. An S.A. must have at least two shareholders. Among private sector entities only S.A.s may issue securities on the stock market.

13. **The Commercial Code requires all companies to keep accounting records and sets forth some basic requirements pertaining to how such records should be kept.** All companies⁹ are required to prepare the following financial reports, on an annual basis: (a) Trial Balance (*Balance de Comprobación*, previously called the *Cierre de Operaciones del Libro Mayor*); (b) Profit and Loss Statement; (c) Balance Sheet; and (d) Statement of Surplus or Application of Surplus (*Estado de Superávit o Aplicación de Sobrantes*). In the case of regulated entities the last statement is replaced by a Statement of Changes in Equity.

14. **S.A.s are required to retain a “legally authorized accountant” to maintain accounting records and sign the required financial reports.** A general meeting of shareholders must be held at least once a year, within three months of the financial year-end, to approve, among other matters, the financial reports and other related documents of the company.

15. **It is good practice to define Public Interest Entities (PIEs)** This has been done in other countries. PIEs typically comprise entities in which there is a significant public interest, such as financial institutions, listed companies, SOEs, and large companies. So far, in Costa Rica, PIEs per se have not been defined. The discussion in the remainder of this section is organized as follows: (a) regulated entities; (b) State-owned Enterprises (SOEs); and (c) non-regulated entities.

A.1. Regulated Entities

16. **Regulated entities comprise (i) listed companies and (ii) financial sector institutions, under oversight and regulation from CONASSIF agencies: banking, financial companies, pension, and insurance.** Not included are leasing and credit card companies, although the latter are regulated indirectly as part of the regulation of financial companies.

⁸ For purposes of this report, “companies” refers to all commercial organizations (except SOEs) operating outside the financial sector.

⁹ Art. 251-271 of the Commercial Code.

17. Regulated entities are required to prepare audited annual financial statements.

- Requirements include a balance sheet, income statement, statement of cash flows, statement of changes in equity, and notes to the financial statements.¹⁰ These companies must submit their audited legal entity financial statements together with the audit report and assessment of the internal control system to their respective regulator within 40 days of the end of the financial year.¹¹
- Audited consolidated financial statements, including the audit report and assessment of the internal control system, are due within three months of the financial year-end.
- A Management Discussion and Analysis or similar report that provides qualitative information, is not required of listed companies. Such a report would be helpful for investors to properly interpret the financial statements. Audit reports are expected to include, however: (i) a management statement on factors that affected operational results for the periods presented in the initial prospectus and its annual update; and (ii) an evaluation of factors and trends in the market that are expected to materially affect results of the company in future periods.

18. Regulated entities are also required to submit unaudited financial statements.

- Regulated entities must submit unaudited quarterly, both legal entity and consolidated, within one month of the quarter-end, together with a “consolidation worksheet” and other supplementary information, as needed.
- Banks, listed companies, and most financial institutions—except insurance companies—must also submit unaudited monthly financial statements to their respective regulator within five business days of the month-end.
- Insurance companies (*Sociedades Agencias de Seguro*) must present biannual financial statements in June and December, within five business days of the respective month’s end.

19. Listed companies and other entities supervised by SUGEVAL are also required to disclose material facts (*hechos relevantes*).¹² A material fact is defined as any event or decision that could have a significant influence on the decisions of investors with regard to the securities or instruments in which they invest. Material facts must be disclosed no later than one business day after the issuer becomes aware of the facts. This requirement has significant implications for financial statement disclosures. Table 4 summarizes the financial reporting requirements for listed non-financial companies.

¹⁰ Art. 1 of SGV-A-75: Agreement on issuance of Periodic Information; Art. 16-18 of Regulation on the Financial Information of Financial Entities, Groups, and Conglomerates; and Art. 3 of the Regulation on External Auditors Applicable to Entities Regulated by SUGEF, SUGEVAL, SUPEN, and SUGESE, published December 22, 2010. See www.sugeval.fi.cr/normativa/Reglamento_del_Mercado_de_Valores/AutExt.doc.

¹¹ See Art. 14 of the Regulation on the Financial Information of Financial Entities, Groups, and Conglomerates

¹² Section II of the Regulation on the Submission of Periodic Information, Material Facts, and other Information Obligations (published in Gazette no. 70 of April 13, 1999).

Table 4 Main SUGEVAL Financial Reporting Requirements for Listed Non-Financial Companies				
Report		Periodicity	Delivery date	Delivery
1	Audited Financial Statements			
1.a	Issuers that do not consolidate or consolidate only with local companies	Annual	40 working days after the annual period	Physical document
1.b	Issuers that consolidate with foreign companies		50 working days after the annual period	
2	Interim Financial Statements			
2.a	Issuers that do not consolidate	Quarterly	20 working days after the quarter/ 42 working days after quarter (if it coincides with the annual report)	Through system
2.b	Issuers that consolidate with local subsidiaries		30 working days after the quarter/ 42 working days after quarter (if it coincides with the annual report)	
2.c	Issuers that consolidate with foreign subsidiaries		40 working days after the quarter/ 52 working days after quarter (if it coincides with the annual) report	

20. **The complete, audited financial statements for the five previous years are required to be published on the regulator's website as well as on the regulated entity's website.** Regulated entities are required to publish financial information on their websites (even if it has not yet been submitted to their respective regulator). There are many overlapping deadlines for publication of these financial statements on the company's own website, as noted below:¹³

- Financial statements of listed non-financial companies, or consolidated financial statements of non-financial groups comprising companies located in Costa Rica, must be posted within 45 days of the end of the financial year.
- If the group includes companies located outside Costa Rica, the deadline is extended by 10 days.
- The deadline for consolidated financial statements of financial conglomerates is 65 days from the end of the financial year.¹⁴

¹³ In the process of defining the delivery dates for listed non-financial companies, it was necessary to establish different time requirements for information presentation between single and consolidated companies, since the former include subsidiaries of consolidated companies. Finalizing the accounts in consolidated companies require greater efforts than in single companies, especially when subsidiaries are located outside the country (and thus may be subject to accounting standards different from those that are required in Costa Rica). Setting a uniform deadline for single and consolidated companies would have essentially shortened the deadlines for single companies, since many of them have to complete their accounting and audit processes prior to the deadline, in order to provide this information for use in a consolidation.

¹⁴ Article 17 of the Regulation on the Financial Information on Financial Entities, Groups, and Conglomerates.

21. All regulated entities must undergo an external audit on an annual basis. Regulated entities must select their auditor from the Registry of Eligible Auditors, which is maintained by SUGEVAL.

- The company's audit committee is responsible for recommending an external auditor, and the board of directors must approve the selection.¹⁵ Changes in the external auditor must be communicated within five days to the respective regulatory agency.
- In addition to financial statement audits, financial institutions under SUGEF and SUPEN supervision are required to undergo external audits to provide assurance with respect to the following: (a) that the institution has in place measures to detect the legitimacy of capital and prevent financing of terrorism; (b) information technology systems (every two years); and (c) integrated risk management systems.

Box 1. Registry of Eligible Auditors Maintained by SUGEVAL

Requirements for Auditor Selection:

- All regulated entities must select their auditors from the official audit registry.
- Conglomerates or other corporate groups may be audited by the same auditor as that of the overall entity; for international companies based outside of Costa Rica, an auditor from the company's home country is permitted, provided the firm is included in the registry, has a local affiliate office, and is a member of CCPA.

Status:

- Currently 38 auditors are included in the registry, including 29 firms and 9 sole practitioners.

Criteria:

- Each regulator determines which firms are eligible in the sectors that they regulate. For the financial sector, potential entrants must demonstrate at least five years of experience auditing financial institutions. For listed companies, potential entrants must demonstrate at least five years of experience in companies of a similar nature.
- Audit firms or individuals can be included in the registry, and there is no specific categorization (e.g. based on size) of the firms, except the eligibility determined by the concerned sector regulator.
- To be included in the registry, auditors must be members of the CCPA. They must submit their request for inclusion together with relevant supporting documentation, including on their experience in particular sectors.
- No due diligence is performed on the information submitted to verify its accuracy.¹⁶
- Inclusion in the registry is a one-time event. Once registered, the firm or individual need not renew or update their registration.
- Auditors may be suspended or removed from the registry in certain situations (e.g., if they are sanctioned by one of the regulators, in which case the suspension is in effect for the duration of the sanctions, after which the sanction is lifted).

Monitoring and Enforcement:

- Annual audit reports are reviewed by the regulator, primarily to check compliance with legal requirements ("cumplimiento normativa") and review the auditors' findings.
- Performance of the auditor is a secondary concern (e.g., audit working papers are subject to review by the regulator, but there is no regular or systematic process for doing so).

¹⁵ Art. 4, Ibid.

¹⁶ The information submitted is however checked by SUGEVAL for completeness, consistency and uniformity. Where this review results in observations, SUGEVAL may require that the applicant make the necessary corrections. In addition, the information submitted is accompanied by a sworn affidavit as to its accuracy and completeness. Any irregularities or omissions by the applicant may affect the auditor's inclusion in the registry or have legal repercussions.

- Different external auditors (separate from those who conduct the financial statement audit) may be hired to conduct these specialized audits; however, these must also be drawn from the Registry of Eligible Auditors.

22. Regulated entities are required to form an audit committee, as a sub-committee of the board of directors.¹⁷

- At least two of the audit committee members must be board members. Additionally, the *fiscal* or the president of the *Comité de Vigilancia* is required to sit on the audit committee. If the institution does not have a *fiscal* or a *Comité de Vigilancia*, the audit committee should include at least three board members.
- The audit committee may also include independent members from outside the company. At least one member must be specialized in financial/accounting issues. To be considered specialized, the member must hold a university degree in business or accounting, and have at least five years of experience.
- Groups or conglomerates may have a single audit committee for the entire group. If this is the case, the audit committee must include at least one board member from each entity that comprises the group; a single member may not represent more than one entity.
- The audit committee has several responsibilities, including proposing to the board of directors the candidates for internal auditor; proposing to the board of directors an external auditor and their terms of reference; reviewing quarterly and annual financial information before it is submitted to the board of directors; and reviewing and submitting to the board of directors the audited annual financial statements, the audit report, supplementary reports, and the management letter. The audit committee is also responsible for avoiding potential conflicts of interest relating to the external auditor (e.g. in cases where the auditor also provides other services to the company).
- The audit committee is required to report biannually on its activities to the board.

23. Regulated entities are required to develop a corporate governance code and issue an annual corporate governance report.¹⁸

- The corporate governance code should describe the governance structure of the entity, its policies, the role and requirements of the board of directors, as well as the control mechanisms to ensure that the entity complies with its corporate governance requirements.
- The board of directors must approve the corporate governance code and is required to review the code annually.
- The annual corporate governance report should include the names of the members of the board of directors, list the sub-committees of the board and their membership, provide name of the external auditor and cite relevant information (how many years the auditor has been auditing the company, whether or not the

¹⁷ Section II of the Regulation on Corporate Governance.

¹⁸ Art. 4, Section IV, and Annex 1 of the Regulation on Corporate Governance – SUGEF-SUGEVAL.

firm also provides other services to the entity, and the mechanisms in place to ensure the external auditor's independence).

24. **Regulated entities thus have broadly similar accounting, financial reporting, and audit requirements.** The main difference is with regard to their accounting standards. Regardless of listing status, financial institutions must follow the requirements of the financial sector regulator, SUGEF, whose regulations supersede those of other regulators, including those of the securities market regulator, SUGEVAL.¹⁹

A.2. State-Owned Enterprises

25. **Legally, SOEs are structured in many different ways, but normally they have a senior official designated by the Government Council (*Junta de Gobierno*).** The *Junta* is chaired by Costa Rica's President and responds only to that senior political level. The board of directors is also designated by the *Junta de Gobierno*; in some cases it includes directors that represent the private sector and other stakeholders.

26. **In spite of a significant presence in Costa Rica's economy, SOEs do not currently have uniform requirements with regard to accounting, audit, disclosure and corporate governance.**

- They currently do not have uniform accounting standards, but are required to apply IFRS from 2014.²⁰
- Audit requirements are established by the CGR. There is no statutory requirement for external audit of SOEs, but according to internal control policies for the Public Sector (*Normas de Control Interno para el Sector Público – N-2_2009-CODFOE*), each institution can decide, based on risk, to request an External Audit.
- In practice, almost every SOE has a financial external audit carried out, but it is not mandatory. SOE's financial statements are mostly audited by private audit firms; CGR does not carry out any audit on SOE's financial statements. CGR performs operational audit on SOEs as part of its work program.
- SOE financial reports are not consistently made public.
- Corporate governance arrangements are established in the law that creates each company.

A.3. Non-regulated Entities (*neither regulated nor state-owned*)

27. **The accounting legal framework for non-regulated entities in Costa Rica is outdated and incomplete.** The legal framework with respect to accounting issues refers to physical ledgers and accounting records and to the secrecy of accounting records.²¹

¹⁹ See Section III A for a description of how accounting standards are set for regulated entities.

²⁰ The requirement for SOEs to adopt IFRS was issued as Decree 35616 of the Accountant General's Office, in November 2009: "Adopción e Implementación de las Normas de Información Financiera (NIIF) para Empresas Públicas Sector Público Costarricense."

²¹ Chapter V of the Commercial Code covers Accounting issues.

28. **Non-regulated Companies are not subject to any requirement on publication of financial statements.** In fact, the Commercial Code states that a company cannot be required by any person or institution to disclose its financial information. Companies can only be required to disclose their financial information to a third party through a court order.²² This level of confidentiality of financial information is uncommon in Latin America and is particularly unusual in Costa Rica's business environment, where so many large foreign firms have subsidiaries that are often economically significant and outside the regulated sectors. A requirement for large non-listed companies to publish their financial statements, while often contentious and difficult to implement, is generally considered good practice. For example, some countries in Latin America (e.g. Brazil) require large non-listed companies to make their financial statements available to the public. Filing of annual accounts by all private commercial companies is also practiced in some countries in Europe.

29. **Non-regulated entities, regardless of size, are not subject to a general audit requirement by any legislation.**

- An external audit can only be required by a court order, upon the request of partners/shareholders. The Commercial Code stipulates that if partners/shareholders representing at least 20 percent of the company's share capital request an external audit, a judge will designate an auditor or audit firm to conduct one. A company's bylaws may stipulate a lower threshold for requesting an external audit.²³
- Further, companies applying for loans above \$1 million are required to present audited financial statements to the financial institution, which are not available to third parties. Although required by statute, these financial statements do not serve as an important input into the credit decision process since, in practice, banks will generally only provide a loan if it is secured. In the case of unsecured loans, the credit decision is based more on the company's reputation and projected cash flow than on their financial statements. The fact that economically significant companies, if outside the regulated sector, are not subject to a mandatory external audit, can hamper the confidence of investors and other interested parties in the financial statements of these companies.

30. **Non-regulated S.A.s have the option of appointing one or more *fiscales*.**²⁴ The Commercial Code gives S.A.'s a great deal of flexibility to determine, in their bylaws, whether or not to appoint a *fiscal*, the range of the *fiscal's* responsibilities, and their term of service, among other things. *Fiscales* are typically responsible for several internal control functions, including review of the company's financial information.

²² Art. 265 of the Commercial Code.

²³ Source: Art. 26 of the Commercial Code.

²⁴ See Art. 193-200 of the Commercial Code.

A. 4 Summary

31. Table 5 below summarizes the accounting and auditing requirements in Costa Rica.

Table 5: Overview of Accounting and Auditing Requirements in Costa Rica				
Type of entity	Regulatory Agency	Accounting Standards	External Audit Requirements	Publication
Banks, Savings and Loans, Cooperatives (i) and Finance Companies	SUGEF	IFRS (January 2008 version) for all regulated entities, with additional prudential rules for SUGEF-regulated entities.(ii)	Annual audit required. Auditor must be registered with SUGEVAL, which manages the registry on behalf of the other regulators. Firms' audit partners are required to rotate every five years.(iii)	Complete audited financial statements must be published on regulated entity's website.
Pension Funds	SUPEN			
Insurance Companies	SUGESE			
Listed Companies	SUGEVAL	IFRS as adopted by the CCPA.		
State-Owned / Enterprises	CGR, Government Council	Government Accounting Standards. IFRS are mandatory from 2014. (iv)	Internal Control Law establishes that an external audit could be requested based on risk assessment by Internal Auditor.	CGR publishes budgetary information but not the entities' audited financial statements.
Non-regulated entities (vi)	None	CCPA has adopted IFRS, but its application is not mandatory. <i>IFRS for SMEs</i> applies to SMEs as narrowly defined.(v)	None	None

(i) Cooperatives of savings and credit that either (a) have assets greater than ₡1.151.02 billion, and of an open nature (composed of partners that do not work for the same legal entity); or (b) have less than this amount of assets, but had been previously subjected to this supervision.

(ii) As defined in SUGEF 33-07 and 34-02, approved by CONASSIF. Prudential rules (or "special treatment") applicable to SUGEF-regulated entities, appear in Chapter 2 of SUGEF 34-02.

(iii) Rotation of firms was proposed, but declared unconstitutional.

(iv) Some SOEs already prepare IFRS financial statements voluntarily. IFRS is mandatory beginning in 2014, as per Decree 35616 of November 2009.

(v) The SME definition used by CCPA comes from the Ministry of Economy, Industry and Commerce through a regulation of Law 8262 (May 2006), which bases the SME classification on a defined formula for different sectors. See "*Definición de Pyme para efectos de la aplicación de Normativa NIIF para las Pymes en Costa Rica*," Acuerdo 504-2010 of CCPA.

(vi) Non-regulated companies include all commercial organizations that are neither regulated nor state-owned.

B. THE ACCOUNTING/AUDITING PROFESSION

B.1. Institutional Structure

32. **Costa Rica has two professional accountancy organizations, each of which is responsible for a different segment of the profession's operations.**

- The *Colegio de Contadores Públicos de Costa Rica* (CCPA) represents those in the public accounting and auditing profession. CCPA members are referred to as “authorized public accountants” (*Contador Publico Autorizado*) or “CPs.”²⁵ They have the exclusive legal responsibility to deliver statutory audit services. CCPA is an IFAC member body.
- The *Colegio de Contadores Privados de Costa Rica* (CCPR) represents accountants and accounting technicians that are normally employed within private sector entities. CCPR members are commonly called “Private Accountants” (PAs). In the private sector, members of CCPR (including those that are also members of CCPA) have the exclusive responsibility, under the law, for the preparation of accounting records and financial statements. CCPA members may also work in the private sector, but must also have CCPR membership to prepare financial statements. CCPR is not an IFAC member body.
- CCPA members must hold a university degree in accounting; or alternatively 120 credit hours of equivalent coursework. They are also required to have two years of professional experience. CCPR members are not required to have a university degree or a minimum level of experience. Non-CCPA members of CCPR (i.e. accounting technicians) must however pass an entry exam on basic accounting concepts.
- As shown in table 6 below, the higher entry requirements of CCPA (University Degree) means it has fewer members than CCPR, bearing in mind that many CCPA members are also members of CCPR.

²⁵ This ROSC review uses the nomenclature of “CPs” rather than “CPAs” to avoid confusing readers for whom English is a first language, and for whom the CPA abbreviation would carry functional connotations that do not, in fact, apply to the competence range of a *Contador Publico Autorizado*.

Table 6: Professional Accounting Organizations in Costa Rica

Name	Date of Incorporation	Membership (approx.)	Annual dues	Affiliation	Entry Requirements	Main Responsibilities	Disciplinary Actions
Public Accountants' Professional Accountancy Organization (<i>Colegio de Contadores Públicos de Costa Rica - CCPA</i>)	1947	6,000	\$180	IFAC, AIC	<ul style="list-style-type: none"> • Bachelor's degree in Accounting (or in Business Administration with an emphasis in Accounting), or 120 credit hours of equivalent coursework. • Two years of professional experience 	Audit and verification of accounting records, mercantile accounts or financial transactions or preparation or certification of financial statements aimed to be public, or for tax or credit purposes.	Applicable by the Board (" <i>Junta Directiva</i> ") and Ethical committee " <i>Tribunal de Honor</i> " on moral issues.
Private Accountants' Professional Accountancy Organization (<i>Colegio de Contadores Privados de Costa Rica - CCPR</i>)	1951	22,000	\$120	AIC	<ul style="list-style-type: none"> • Accounting / Business Administration degree, from university or technical institutes (as "<i>Peritos Mercantiles</i>"). • Persons with non-accounting degrees should pass an examination. 	To attend to any legally required accounting.	Applicable by the Board " <i>Junta Directiva</i> " and Ethical committee " <i>Tribunal de Honor</i> " on "moral" issues.

33. **It is essential that both bodies operate in a fully professional capacity and complement each other.** CCPA and CCPR co-exist without significant overlap in their functions. Such a bifurcated system exists in other countries in the region (e.g., Brazil) and in many countries in continental Europe. To be effective, both bodies should complement each other in the oversight and strengthening of the accountancy profession, comply with their legal responsibilities, and meet internationally recognized requirements, such as the International Federation of Accountants (IFAC)'s Statements of Membership Obligations (SMOs).

B.2. CCPA

34. CCPA is a member of IFAC and as such is required to meet IFAC's seven Statements of Membership Obligations (SMOs).

- The SMOs serve as a framework for professional accountancy organizations to serve the public interest by adopting, or otherwise incorporating, and supporting implementation of international standards. The SMOs also require the maintenance of adequate enforcement mechanisms to ensure the professional behavior of the professional accountancy body's individual members. IFAC member bodies are expected to address the activities for which they have direct responsibility, and use their best endeavors to promote other responsible organizations to meet SMO requirements.
- Currently, CCPA is not in full compliance with most SMOs (see Table 7). Furthermore, the SMO Action Plan prepared by CCPA has met with implementation challenges and the likelihood of meeting IFAC requirements in the short-term remains uncertain.

Table 7. CCPA Compliance with IFAC Statements of Membership Obligations (SMOs) ²⁶			
SMO No.	Issue Covered by SMO	Comments	Compliance with SMO
1	Quality Assurance	Quality assurance program not yet in place, although some initial steps have been taken	Low
2	International Education Standards (IES)	- University degree required to become member. - No minimum curriculum standards - No entry examination in place - Two years Practical Experience Requirement (one year less than recommended by IFAC) - No CPD requirement in place	Low
3	International Standards, Related Practice Statements and Other Papers Issued by the International Accounting Standards Board (IASB).	- ISA adopted in statute - Need for establishing a process to advise members of new and revised standards	Medium
4	IFAC Code of Ethics for Professional Accountants	- CCPA's Code of Ethics is somewhat up to date, having been approved in 2006, but some changes are needed to meet IFAC standard. - Additional training activities may need to be developed to further ensure proper implementation of the standards	Medium

²⁶ SMO 5 relates to compliance with the International Public Sector Accounting Standards (IPSAS), which is outside the scope of this report.

SMO No.	Issue Covered by SMO	Comments	Compliance with SMO
6	Investigation and Discipline	<ul style="list-style-type: none"> - CCPA only investigates specific complaints, and sanctions are rare or non-existent - The appeal process needs to be improved in accordance with SMO 6 requirements 	Low
7	IFRS	<ul style="list-style-type: none"> - IFRS adopted, but not mandated by legislation - Substantial training provided by CCPA - No implementing regulations issued - Slow implementation in practice 	Low

Source: Assessment prepared by CR ROSC Team based on CCPA information.

35. CCPA's Code of Ethics incorporates some elements of a former version of the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA).

- The CCPA's Code of Ethics was approved on August 17, 2006. The Code was amended in January 2010 following an administrative ruling that required CPD to be voluntary rather than mandatory. According to its Compliance Program Action Plan, which is published on the IFAC website,²⁷ CCPA plans to update its Code in accordance with the current version of the IESBA Code of Ethics to meet the requirements of the requirements of the IFAC SMO 4, *IESBA Code of Ethics for Professional Accountants* in the next year.
- CCPA does not have any arrangement to provide advice to its members to help resolve ethical conflicts. In addition, there is no communication program in place to make individual members aware of their full ethical requirements and the consequences of non-compliance with professional ethics requirements, and training on ethical matters could be enhanced to further assist CCPA members with the implementation of the standards.

36. CCPA has taken initial steps toward establishing a quality assurance review system for its members, but it is still far from compliance with the relevant SMO in this regard. CCPA coordinates a voluntary quality assurance review system, with support from the accounting firm KPMG, which has developed a detailed quality assurance proposal. Piloting of this approach is under way, and CCPA is providing training on this subject. A number of issues are still to be defined including whether quality assurance (QA) is mandatory and the modality for reporting on the QA process. The CCPA is also looking to contract a person to be in charge of its Quality Control Committee.

²⁷ The IFAC website can be accessed at www.ifac.org

37. **CCPA members receive group indemnity insurance, but the value of the policy is too small to be meaningful.** As a benefit of membership, CCPA provides coverage for up to 1 million colones of claims, or only about \$ 2,000. While claims of liability have apparently been rare, the level of coverage is not likely to be sufficient to cover legal expenses and damages from a claim pertaining to an accountant's alleged negligence. 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. While members of larger firms may be covered by their firm's indemnity plans, other public accountants run a financial risk by not having sufficient liability coverage.

B.3. CCPR

38. **CCPR is an organization of accountants and accounting technicians (*contabilistas*) regulated by the Private Accountancy Body Law (1269).** This law requires all those working as accounting professionals (commonly called "Private Accountants" - PAs) to be a member of CCPR. CCPR is not a member of IFAC. It does not adhere to IFAC's SMOs, nor does it have plans to, especially regarding CPD. Moreover, CCPR has yet to promote the application of IFRS among its members. In the ROSC questionnaire submitted as part of this review, CCPR stated that it does not recognize IFRS as a legally required standard for Costa Rica. CCPR also stated that the mandatory requirements in the country are standards issued by Costa Rica's tax authority²⁸ and CGR.

B.4 Legal Framework for Professional Accountancy Organizations

39. **There is scope to improve the legal framework relating to the professional accountancy organizations.** There is no Accountancy Law per se. The Commercial Law and the CCPA and CCPR Laws, 1038 and 1269 "regulate" the accounting profession. These laws mainly focus on the institutional framework of the accountancy bodies and their respective spheres of operation. The laws applicable to Costa Rica's accountancy bodies overwhelmingly focus on internal procedures and the institutional articulation of the bodies themselves, rather than on obligations that would strengthen the profession and require them to function as modern professional accountancy organizations that serve the wider interests of the public and contribute to developing Costa Rica's economy. The legal framework lacks some important aspects with respect to standards-setting, support to implementation of international standards, enforcement, requirements for professional accountancy organizations and their members, and quality assurance functions.

²⁸ *Dirección General de Tributación* (DGT), a unit of the Ministry of Finance.

C. PROFESSIONAL ACCOUNTANCY EDUCATION AND TRAINING

40. **CCPA membership requires a university education in accounting along with two years of practical experience.** To meet the education requirement, the applicant must provide evidence of either (a) a bachelor's degree in accounting; (b) a bachelor's degree in Business Administration with an emphasis in accounting; or (c) the completion of 120 credit hours in courses equivalent to these degrees, including at least two years of consecutive study.²⁹ Applicants must also demonstrate two years of practical experience (one year less than that recommended by IFAC). There is no other specified program of study or entry examination to obtain CCPA membership, which is at variance with international practices.

41. **Entry requirements for CCPR are somewhat different, and less stringent, than those of CCPA.** Like CCPA, CCPR accepts applicants with a bachelor's degree in Accounting or Business Administration, but unlike CCPA, CCPR also accepts graduates with "accounting expert" diplomas ("*Peritos Mercantiles*") from technical institutes. In addition, CCPR provides additional flexibility by allowing non-degree holders to enter the organization by passing an examination on basic accounting concepts.

42. **The quality of university accounting education varies.** Curricula tend to be particularly weak in terms of IFRS, ISA, and professional ethics, due in part to a lack of expertise among accounting professors, although recent training efforts by CCPA have helped to ameliorate this situation. Given that only a university education in accounting is a prerequisite for a public accountant (CCPA) license, the proliferation of lower-quality university accounting degrees is a worrisome trend. To ensure a baseline of quality in tertiary education, other countries in the region (e.g., Argentina, Brazil, and Peru) have moved toward a system of program evaluation and an accreditation process. A career accreditation system in Costa Rica, SINAES,³⁰ exists, but only two university accounting programs have been accredited; apparently, the market does not attach substantial value to accreditation and there is little interest from universities.

43. **Continuing Professional Development (CPD) for professional accountants is not a mandatory requirement in Costa Rica.** Previously, there was an attempt to make CPD mandatory. This was challenged in the courts and struck down, making CPD strictly voluntary.³¹ CPs in Costa Rica thus do not complete a uniform set of continuing professional education courses and training.

44. **While CCPA does not provide specific guidance or support to its members in terms of practical application of IFRS, they, along with other private education providers, have been offering many IFRS courses and seminars.** Thanks in part to the

²⁹ Regulation to clarify the CCPA Law 1038: "Reglamento del Trámite y Requisitos de Incorporación al Colegio de Contadores Públicos de Costa Rica." Published in the national Daily Gazette N° 122, June 26, 2003.

³⁰ Sistema Nacional de Acreditación de la Educación Superior, www.sinaes.ac.cr

³¹ Resolution 633-2010 of the Administrative Conflict Tribunal.

IDB-financed PROMECIF project, an IFRS training and certification program has been established, with 958³² certificates issued for different modules. The program was established for both CCPA and CCPR members. IDB's evaluation of the PROMECIF project noted that political differences between the CCPA and CCPR served to limit the program's impact to the efforts of the individual accountancy organizations, thus failing to realize potential synergies of carrying out a joint program.³³

D. ENFORCEMENT OF COMPLIANCE WITH FINANCIAL REPORTING REQUIREMENTS

D.1 Regulated Entities

45. **The regulatory superintendencies are in charge of enforcing accounting and financial reporting requirements.** Monitoring of each regulated sector is conducted by the responsible superintendency. In recent years there have been cases of sanctions of auditors and also of regulated entities for failures to adhere to promulgated standards.

Listed Companies

46. **SUGEVAL (Stock Market Superintendency) has four staff members in its Compliance Unit** (*Área de Cumplimiento de Normativa de Emisores de la División de Supervisión de Fondos de Inversión y Emisores*), who are responsible for monitoring compliance with accounting and audit requirements for non-financial listed companies.

47. **For the securities market, there are sanctions for failing to comply with financial reporting obligations, but these are not applied regularly.** The Securities Market Law sets forth a number of “very serious” offenses and “serious” offenses, as well as their respective sanctions. Failing to comply with accounting standards is considered a serious offense, and listed companies that do so, can have their listing suspended for a year.³⁴ Willfully publishing fraudulent or incomplete financial statements is a crime under the penal code, and directors, managers, or *fiscales* convicted of such can be incarcerated for up to two years (four years for listed companies).³⁵ However, most common infringements (e.g., failure to submit financial information in a timely manner, failure to publish financial statements) fall under the category of minor offenses, which are not enumerated specifically and are sanctioned either by a non-published warning or a fine. There have been instances of infringement, including listed companies that did not publish their financial statements on their company website at all, or did not publish the requisite audited financial statements of the previous five years. Perhaps because they are not enumerated specifically, these types of infringements have often not been sanctioned.

³² Annual CCPA report, December 2010.

³³ See Financial Information Quality Improvement Program (PROMECIF) (ATN/MT-8843-CR).

³⁴ Art. 159 and 160 of Accounting Standards for Entities Supervised by SUGEF, SUGEVAL, SUPEN, SUGESE, and Non-Financial Listed Companies (October 2009).

³⁵ Art. 240 of the Penal Code.

Financial Sector

48. **SUGEF (Superintendency of Banks) has three directorates focused on supervision: one for state-owned banks and mutual funds, another for private sector banks and financial groups, and a third for cooperatives and non-bank financial entities.** The directorates are organized into groups that are responsible for supervising a certain number of banks; they conduct both in-situ and extra-situ inspections. Among their monitoring activities, they cross-check the monthly information received through the system with that contained in the periodic and annual financial statements. These reviews mainly focus on ensuring compliance with the prudential reporting requirements.

49. **For the banking sector, the available sanctions relating to infringements of financial reporting requirements are as follows:**³⁶

- *For submitting incomplete, inaccurate or false information:* banks are given a written warning. If this is not heeded, they are barred from participating in the foreign exchange market or required to reserve 100 percent of increases in liabilities for a period of one to 90 days.
- *For failing to publish a restatement upon request of the superintendency:* barred from participating in the foreign exchange market or required to reserve 100 percent of increases in liabilities for a period of one to 90 days.
- *For altering accounting records or intentionally presenting incomplete or false information:* barred from lending for a period of one to 90 days.
- *For refusing to submit financial or operational information:* fine in the amount of one percent of the bank's assets.

50. **In addition to the above, external auditors of regulated entities can be sanctioned as follows:**

- *For submitting late or incomplete information to the superintendency:* written warning. After five such warnings, the auditor or audit firm may be suspended from the auditor registry for three months to one year.
- *For not reporting to the superintendency issues relating to instability or financial irregularity due to negligence:* suspension from the auditor registry for a period of one to five years.
- *For, inter alia, intentionally omitting information, presenting confusing or false information, with the intent to hide the real financial situation or mask the financial risks of an entity, or for not reporting issues relating to a high degree of instability or financial irregularity:* permanent exclusion from the auditor registry.

51. **Although sanctions are made public on the SUGEVAL and SUGEF websites, these websites could be more user-friendly.** In the case of SUGEVAL, it is not clear why the companies have been sanctioned; the website states that the entity violated a specific article of a resolution, but it does not specify the infringement. However, the full

³⁶ Art. 155 of Law 7558 (Organic Law of the Central Bank), of November 1995 (as amended).

text of the sanctioning resolution is made available.³⁷ In the case of SUGEF, one must search for sanctions using a number of search parameters, and results are prone to system error. This significantly restricts the deterrent effect of public sanctions.

52. Enforcement of financial reporting requirements for other non-banking financial institutions, such as lending companies (*financieras*) and savings and loan firms, also falls under SUGEF regulation and supervision. However, leasing companies and credit card companies managed by non-bank financial institutions are not currently regulated. There is a legislative proposal under consideration to include leasing companies under the regulated sectors. Also, due to the very recent opening of the insurance market, there is little practical information on monitoring and enforcement activities of SUGEF at this point.

D.2 State-Owned Enterprises

53. SOEs in Costa Rica are subject to the control and oversight of the government's supreme audit institution, the CGR. The CGR's powers and responsibilities are contained in its Organic Law and the national Internal Control Law.³⁸ SOEs are also required to respond to any information requirements of the Accountant General's Office, which sits within the Ministry of Finance. More general oversight is carried out by the SOE's Government Council (*Junta de Gobierno*).³⁹

D.3 Auditors

54. The oversight of auditors in the regulated entities needs further strengthening in line with international good practices.

- The regulatory agencies do exercise some forms of oversight on audit firms and the sanctions are published in regulated sector bulletins. Auditors or firms that conduct audits with serious deficiencies are permanently removed from the auditor registry. They can also be fined 5 percent of the audit firm's assets.⁴⁰ Investigation of the audit firms is conducted over each regulated sector by the responsible superintendency of that sector, but sanctions are enforced across all the sectors since they share the audit registry.
- There is no arrangement for conducting independent audit quality assurance review on a regular basis and in a proactive manner. Annual audit reports are reviewed by the regulator, primarily to check compliance with legal requirements ("cumplimiento normativa") and review the auditors' findings. Performance of the auditor is a secondary concern (e.g., audit working papers are subject to review by the regulator, but there is no regular or systematic process for doing so)

³⁷ SUGEF believes that providing summary information runs the risk that the results of the case will be misinterpreted.

³⁸ See Article 46 of Law 8292, July 31, 2002.

³⁹ See Section II A.2 for additional information.

⁴⁰ Art 157 and 158 of Accounting Standards for Entities Supervised by SUGEF, SUGEF, SUPEN, SUGEF, and Non-Financial Listed Companies (October 2009)

55. CCPA mechanisms for investigating and disciplining its members for misconduct and breach of the rules could be more effective.

- CCPA is the professional accountancy organization charged with oversight of compliance with auditing standards (including non-regulated entities, where the regulators do not play any role), but this function is little realized in practice as CCPA's processes are lengthy and complex, with no real impact on the profession. While the bylaws of the professional accountancy organization refer to the Honor Councils (*Tribunal de Honor*), this body is essentially inactive. No sanctions are posted on the CCPA's website or in any of the newsletters published recently. The experience with Honor Councils across the region is that they are generally not credible enforcement bodies.
- **CCPA does not fully meet the requirements of IFAC's SMO 6, Investigation and Discipline.** CCPA's Board has the authority and responsibility to apply disciplinary actions that are considered adequate caused by non compliance of legal or regulatory regulations, ethics code and the fees established. However, its organizational structure and processes do not support the disciplinary function that would be necessary to strengthen compliance with accounting and auditing standards and make it difficult to carry out disciplinary actions against violators of applicable standards and professional codes. CCPA's Prosecutor's Office conducts ex officio inspections and also conducts complaints-based investigations, which can ultimately result in punishment of members – but judgment with respect to breaches of ethical requirements is the responsibility of the Honor Tribunal. Other types of breaches are referred to CCPA's Board of Directors. In such cases, it has the power to impose sanctions, which can include a fine, temporary suspension to practice, or expulsion. CCPA plans to strengthen the Prosecutor's Office in conjunction with the implementation of a new quality assurance system.⁴¹

⁴¹ Article 24 of Law 1038 and Articles 53, 60 and 61 of Decree 13606 regulating Law 1038.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

A. ACCOUNTING STANDARDS AS DESIGNED

56. **CONASSIF is responsible for setting accounting standards for regulated entities** i.e., listed companies and financial sector entities (banking, financial companies, pension, and insurance). For non-financial listed companies, CONASSIF has accepted the standards set by CCPA (for private companies) and the Ministry of Finance (for SOEs).⁴²

57. **CONASSIF has adopted IFRS,⁴³ but there is currently no periodic or automatic process to review and adopt new IFRS pronouncements.** The adoption of IFRS is a significant positive action. Its benefits would be enhanced through an automatic process to adopt new IFRS pronouncements. This would include activities, such as review of new and revised standards, publication of exposure drafts, incorporation of comments, and promulgation and dissemination of the standards. In the absence of this automatic process, gaps are likely to exist between CONASSIF's accounting regulations and the latest IFRS.

58. **CONASSIF maintains an “Accounting Standards Committee” which convenes on an ad hoc basis.** The Committee is comprised of representatives from each sector regulator (SUGEF, SEGEVAL, SUGESE, and SUPEN). Meetings are called at the request of one of the superintendencies to review accounting standards or other financial reporting regulations. A regulated entity may also ask its respective superintendency to initiate a request on its behalf. If the meeting is called to revise or update accounting standards, the Standards Committee will produce an exposure draft that is submitted to CONASSIF, which is responsible for disseminating it among interested parties. The Accounting Standards Committee reviews the comments received and amends the exposure draft as appropriate; the final version of the standard is issued by CONASSIF.

59. **The regulated entities share a common chart of accounts,** but for their specific sectors, each superintendency has the authority to set specific clarifications and additions to the common chart of accounts.

Financial Sector

60. **Regulated financial sector entities are required to follow IFRS, but apply versions that differ from the most current ones.** As per the regulations referred to

⁴² Article 3 of the Accounting Regulations (see details in the following footnote).

⁴³ Accounting Regulations (*Normativa Contable*) for Entities Supervised by SUGEF, SEGEVAL, SUPEN, SUGESE, and Non-Financial Listed Companies (2007, modified in 2010). Approved by CONASSIF in Articles 7 and 13 of sessions 691-2007 and 692-2007, respectively, carried out on December 17, 2007. Published in the *La Gaceta* No. 11, January 16, 2008. Updated May 26, 2010.

above, financial institutions are required to apply IFRS as they stood in January 2008, with certain modifications. The regulation that requires IFRS was issued in 2007 and was updated only once (in 2010); it requires applying IFRS pronouncements as of January 2008. Relevant portions have not been updated since then. The modifications to IFRS 2008 are set forth in the same regulation and are discussed further below. If a situation calls for a particular accounting treatment that is not covered under “modified IFRS 2008”, the regulation allows financial institutions to apply IFRS as adopted by CCPA (current IFRS), or if not covered by current IFRS, to apply US-GAAP. Similarly, the notes to the financial statements are to follow IFRS as adopted by the CCPA (i.e., the current version).

61. Due to the complexity of various regulatory requirements, gaps exist between IFRS requirements and local requirements for regulated financial sector entities. The following are the major differences for the financial sector (a fuller list of the differences between SUGEF - Superintendency of Banks’ requirements and IFRS are outlined in Annex 1 of this report):

- Non-adoption of the statement of comprehensive income;
- Held-to-maturity investments cannot be recorded as such;
- Finance lease contracts substantially treated as operating leases;
- Arbitrary calculation of asset impairment provisions;
- Consolidation of subsidiaries without a majority participation;
- Application of the equity method of accounting for subsidiaries in stand-alone statements rather than the cost method;
- Flexibility in the capitalization of certain expenditures for property, plant and equipment;
- Mandatory periods for amortization of intangibles that should be subject to impairment tests or not capitalized at all; and
- Requirement of full provision for non-current assets held for sale not sold within two years after designated in such category.

Listed Companies

62. Non-financial listed companies in the private sector are required to follow the accounting standards adopted by the CCPA (i.e., current IFRS).⁴⁴ As noted earlier, formally, CONASSIF is responsible for setting the accounting standards for listed companies, but through statute it has given this responsibility to CCPA and the Ministry of Finance.

⁴⁴ Art. 3 of Accounting Standards for Entities Supervised by SUGEF, SUGEVAL, SUPEN, SUGESE, and Non-Financial Listed Companies (2007).

State-Owned Enterprises (SOEs)

63. **State-owned non-financial companies follow the accounting standards set by the Ministry of Finance, and are required to apply IFRS beginning in 2014.**⁴⁵ SOEs are governed by the “*Accounting Principles Applicable to the Costa Rican Public Sector*”.⁴⁶ The Accountant General’s office (*Contabilidad Nacional*), which is part of Ministry of Finance, is the technical body responsible for ensuring IFRS implementation in SOEs.

Other Aspects

64. **CCPA adopted IFRS in 2005.**⁴⁷ CCPA members are required to ensure application of IFRS in the financial statements that they audit, as a consequence of their professional affiliation. There is no formal ongoing endorsement process for IFRS by CCPA i.e., new IFRS standards issued or amendments are adopted automatically, as they are issued by the IASB, with the same date of effectiveness. However, a few issues are highlighted below.

- There is no statutory requirement for the companies themselves—except for regulated entities—to apply IFRS or any other standard.
- CCPR, whose members are the preparers of financial statements, has yet to promote the application of IFRS.
- Neither CCPA or CCPR, nor the sector regulators, have participated in IASB’s standard-setting process (e.g., through sending comments to exposure drafts). Since the IFAC member body in Costa Rica - CCPA- has adopted IFRS on such a broad basis, it would be in its interest to take a more active role in the standards-setting process.

65. **The tax administration authority (DGT) has adopted the accounting standards issued by the CCPA, and, therefore, IFRS as well.** However, there is no enforcement from the tax agency and only a tax declaration is required by companies for tax purposes. Commercial banks accept the tax declaration as a valid financial statement for loan processing, undermining effective application of IFRS. One way this undermines IFRS implementation is that it provides an incentive for more accounting students to specialize in tax issues, rather than making the effort to fully understand IFRS.

66. **In summary, accounting/financial reporting standards (as designed) vary widely.** These include aspects of IFRS, and the financial reporting principles imposed by regulatory agencies. This situation is an obstacle to comparability and reliability of accounting information, which may be confusing for the end-users of financial statements. In addition, there is a divergence in the accounting and financial reporting standards to be

⁴⁵ This requirement was issued through Decree 35616 of Costa Rica’s President and Ministry of Finance, of November 4, 2009: “*Adopción e Implementación de las Normas de Información Financiera (NIIF) para Empresas Públicas Sector Público Costarricense*”, as published in La Gaceta, No. 34, December 2, 2009.

⁴⁶ As established in Executive Decree 34460-H of February 14, 2008.

⁴⁷ Circular 06-2005 of the CCPA, published in La Gaceta No. 238, December 12, 2005.

followed by regulated entities versus non-regulated entities and SOEs. An approach that entities with significant public interest (e.g., financial institutions, listed companies, SOEs, and large companies) should be subject to a stricter regime is widely recognized on an international level. This approach is reflected in Costa Rica in the standards for listed companies and financial institutions, and SOEs starting in 2014. However, notably lacking is any requirement for “large” companies (however they may be defined) to prepare and/or file audited financial reports in accordance with stipulated standards.

B. OBSERVED FINANCIAL REPORTING PRACTICES

67. Observed reporting practices show opportunities for improvement in the application of IFRS. A number of flaws were identified in the actual application of IFRS or the other accounting frameworks in the financial information reviewed. These are largely concentrated in entities not audited by major accounting firms in the country, which suggests that the more sophisticated the accounting firm, the better the financial reports produced. The obvious reflection is that this derives from the fact that first- and second-tier firms have ready access to international databases and education on accounting, auditing, and reporting topics, which enable them to keep abreast of relevant developments and generate relatively higher quality outputs.

68. Most shortcomings identified have to do with disclosure. Most commonly these take the form of inadequate explanations of transactions or balances, or excessive descriptions of items such as (a) calculations of regulated price adjustments, (b) credit and other risks, (c) historical information such as data of transactions that took place years ago or the evolution of the legal status of the entity, (d) details about the differences between IFRS and local principles, which do not apply to any of the balances and transactions reflected in the statements, or (e) future changes in IFRS that will not affect the reporting entity. Additional shortcomings include the following:

- Lack of comparative information;
- Non-disclosure of reasons for the use of the US dollar as the functional currency;
- Valuation of financial instruments at amortized cost using the effective interest method not fully adhered to;
- Valuation at cost of financial instruments that should be recorded at fair value;
- Valuation of investments in subsidiaries following the equity method in stand-alone statements;
- Classification of investment property as fixed assets;
- Non-disclosure of leasing arrangements;
- Use of arbitrary methods for impairment of assets calculation in the context of IFRS;
- Incomplete disclosure of transactions with related parties;
- Non-disclosure of key management compensation;
- Non-disclosure of information on recognition of income items;
- Absence of segment reporting information; and
- Omission of date of authorization for the issuance of financial statements.

69. **SOEs have reached various stages of compliance with IFRS.** Some are already preparing financial statements based on IFRS.⁴⁸ The largest SOE (ICE) has a program that aims for full adoption of IFRS by 2014, as is required for all SOEs.

70. **CCPA opted for full adoption of IFRS years ago, but has, so far, substantially failed to familiarize its members with IFRS or create an enforcement infrastructure.** Some efforts have been made in terms of courses, presentations, and attendance in meetings and seminars abroad, but no tangible results have been achieved.

71. **In summary, while major steps have been taken toward full application of IFRS, important challenges remain.** Some essential elements of future progress await a political decision to (a) strengthen enforcement by both the professional entities and regulators, (b) improve professional accounting education and continuing professional development, and the facilitation of access to international accounting information via immediate translation of basic literature and dissemination thereof, and (c) improve the command of English language among current and future professionals.

⁴⁸ The degree of compliance of these SOE financial statements with IFRS was not verified by the ROSC team.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

72. **ISAs were formally adopted in Costa Rica by the CCPA**, the sole professional accountancy organization regulating the audit profession. CCPA originally adopted ISA in 1998.⁴⁹ In 2005, it ratified ISA adoption, updated all relevant agreements for the latest standards, and agreed that any subsequent modifications to ISA would be incorporated automatically.⁵⁰ Auditors of the financial statements of all regulated and non-regulated entities (i.e. not including public sector entities) are expected to follow the requirements set by CCPA.⁵¹ Publication of CCPA's decision (to adopt the ISAs) in the official gazette was limited to the enunciation of the topics embraced by the rules. Enforcement has been delegated to the regulators and CCPA.

73. **The ROSC team reviewed a sample of audit reports of Costa Rica companies (including SOEs).** The most specific findings (based on the analysis of 14 Financial Statements of listed companies) were:

- One report prepared to comply with requirements of a third party inappropriately states that the financial statements “present fairly” the financial position of the company. It should have expressed an opinion on compliance with the requirements of the third party instead. The financial statements were also substantially at variance with IFRS which would have normally called for a qualified opinion;
- In two cases, auditors expressed their opinion that the statements had been prepared in accordance with IFRS when they were not;
- In one case, the auditors did not define their relationship with supplementary information attached to the statements on which they were reporting;
- In one case of an audited company which was income-tax exempt, the auditors' report was silent about the existence of an income tax deferred asset;
- The same report was silent about discrepancies with IFRS in the treatment of the impairment of certain assets clearly mentioned in a note;
- The same report indicated that no conclusion was possible on the figures shown for property, plant, and equipment because of internal control problems; and the report included a qualification for that matter. However, the inclusion of a simple qualification rather than a disclaimer is debatable since property, plant, and equipment amounted to some 60 percent of total assets and approximated total net equity; and

⁴⁹ *Acuerdo No. 32-1998 de la Sesión Ordinaria No. 24-1998 de la Junta Directiva del Colegio de Contadores Públicos de Costa Rica* (November 24, 1998).

⁵⁰ *Circular N° 07-05* (November 14, 2005). See www.ccpa.or.cr/file/Circular07-2005.pdf

⁵¹ For listed companies, CONASSIF has legal authority for establishing auditing standards (Article 81 of Law 7983 – which specifically states that whenever there are conflicts with CCPA's standards, CONASSIF's decision will prevail). However, in practice, CONASSIF accepts CCPA's authority with respect to auditing standards, choosing instead to focus on audit reporting requirements (e.g. periodicity) for regulated entities.

- One of the audit firms sent their report together with a cover letter stating that “the various accounts appear satisfactory and adequately supported.” This would be tantamount to a second opinion, which by itself is inadmissible, but the situation is rendered even less satisfactory considering that the statement made in the letter contradicted the contents of the report, which is qualified.

74. **Effective enforcement of auditing standards appears to be deficient.** Neither the regulators nor the professional accountancy organizations appear to have the resources or structure to conduct effective enforcement activities; indeed, to date only a few extreme cases of infraction have been dealt with. CCPA has only recently initiated a process that provides for timely and complete dissemination of international auditing standards. Furthermore, CCPA does not have sufficient capacity to facilitate implementation of the IAASB pronouncements, including international standards on quality control and ISA.

75. **This situation requires the creation of an institutional infrastructure and the recruitment and/or training of personnel capable of conducting oversight tasks efficiently and independently.** Staff of a reformed CCPA could undertake oversight tasks and fully establish the quality assurance review system they have started to develop. Education and access to international literature are necessary, but initially some international technical assistance may be required. CCPA could be the umbrella for the oversight function in partnership with a team composed of staff from all the superintendencies, following an annual plan.

V. PERCEPTIONS ON THE QUALITY OF CORPORATE FINANCIAL REPORTING

76. **The quality of audited financial statements varies significantly according to the capabilities of auditors.** Interviews with clients of the accounting firms and various users of the financial statements support the view that the financial information audited by reputable audit firms are reliable, while other published statements are far less reliable as a source of credible information.

77. **CCPA and CCPR are perceived as in need of capacity support to enhance the accounting profession.** Most users believe that the profession needs considerable strengthening and that the number of qualified professionals is still too limited to meet all current, much less future, needs.

78. **Few of the universities in the country are considered to be prepared to train high quality future professional accountants and auditors.** In interviews, partners of the larger audit firms in Costa Rica expressed their preferences for hiring graduates of certain universities. The general consensus in the conversations maintained during the study is that the difference in quality is recognized by the profession.

79. **Most of those interviewed shared the view that the legal regulatory framework should be updated to ensure quality and robust financial reporting.** At the same time, they expressed concerns about the timing of any reform process that would be lengthy and difficult, since it is considered necessary to obtain a certain consensus in the profession before reforms are decided and implemented. Experience shows that it is common for individuals or groups to oppose specific reforms in the profession, such as in the case of legal actions taken against the initiative to enforce continuing professional development (CPD) in Costa Rica.

80. **Discussion with various stakeholders revealed that financial information for small and medium enterprises (SMEs) is usually of non-audited nature, and is frequently prepared solely for tax presentation forms and records.** The perception is that the audit profession in these cases does not provide added value. In those cases where bank regulations require audited financial statements, audit services are demanded, but the information is not of good quality, and the audit is seen as adding little value to the financial information. This can also be seen in that bank loans in Costa Rica are usually extended only with collateral or based on a company's reputation.

VI. RECOMMENDATIONS

81. **The policy recommendations outlined in this section emerge from the review of corporate financial practices in Costa Rica, as well as the valuable inputs received from stakeholders.** A holistic approach is adopted to design the policy recommendations in order to strengthen corporate financial reporting and auditing practices in Costa Rica. These primarily principles-based recommendations are expected to provide inputs for a detailed Country Action Plan for Costa Rica, geared toward a sustainable high-quality corporate financial reporting regime. The recommendations are aimed at the country's authorities.

82. **Sustainable improvements and successful reforms require addressing all key aspects of a strong corporate financial reporting framework, from sound laws to adequate education systems to robust enforcement.** Although Costa Rica is moving in the right direction with regard to accounting and auditing standards/practices, and generally rates well vis-à-vis its Central American counterparts, it falls short of international good practice in a number of areas. To a large extent, the quality of financial reporting depends on designing, implementing, and ultimately sustaining a proper monitoring and enforcement mechanism through three crucial links:

- Top management of corporate entities, with legal obligations to prepare the financial statements following appropriate standards, must ensure that standards are applied properly;
- Auditors must discharge their professional responsibilities independently in order to provide assurance that financial statements have been prepared in accordance with the applicable standards; and
- Regulators must ensure that the preparers and auditors of financial statements have complied with the requirements, and consistently take actions against violators.

83. **The policy recommendations of this ROSC are mainly focused on:**

- Aligning the financial reporting and auditing standards in Costa Rica with international standards;
- Building the capacity of regulators and professional accountancy organizations;
- Improving accounting and auditing education and training arrangements in the country;
- Implementing a functional audit quality review system; and
- Updating the legal/statutory framework to support sound corporate accounting, auditing, and financial reporting practices;

Specific recommendations are detailed below.

A. IMPLEMENTING INTERNATIONAL STANDARDS

84. ***Fully align accounting and auditing standards in Costa Rica with international standards.*** Costa Rica has already taken positive steps to align with IFRS and ISA, including the adoption of IFRS for regulated entities, and from 2014, for SOEs, and CCPA's adoption of ISA. Its benefits would be enhanced through improvements in three areas:

- **Aligning accounting standards with the current IFRS, and having an automatic process to adopt new IFRS pronouncements.** Other requirements which are duplicative or not fully conforming to the current IFRS (e.g., those stipulated by regulatory agencies) should be removed;
- **Establishing a clear single standard-setting process/institution.** The standard setting institution should be legally empowered, sufficiently resourced in terms of technical capacity and funding, and include representatives of key stakeholders. It could be an independent entity (such as the CFC in Brazil), or a committee led by one entity with representatives from others. One approach would be for a standard setting committee led by CCPA to issue the applicable financial reporting and auditing standards. The committee would include representatives from CONASSIF (which includes all the regulatory agencies) and perhaps other entities; and
- **Ensuring that the full range of public interest entities (PIEs) such as listed companies, financial sector institutions, and large companies prepare audited financial statements in accordance with appropriate standards.** In particular, there is need for "large" companies to prepare and/or file audited financial reports in accordance with stipulated standards. Appropriate differentiation should be made to take into account to ensure that requirements are appropriate to the size of the companies and not burdensome. For example, the simplified version of IFRS (*IFRS for SMEs*) could be used for medium-size enterprises. For small enterprises, in particular, accounting and audit requirements should be simple, so that they are not subject to burdensome obligations without commensurate benefits to society. These are summarized in Table 8.

Table 8. Recommended Financial Reporting and Auditing Standards			
Type	Financial Reporting	Audit	Comments
Public Interest Entities: <ul style="list-style-type: none"> • Listed companies • Financial institutions • SOEs • Large non-listed companies 	IFRS	Audit using ISA	Already done for listed companies and financial institutions; and for SOEs from 2014.
Other non-listed companies and medium-size enterprises	IFRS for SMEs	Audit using ISA	
Small enterprises (excluding micro enterprises)	Simplified reporting framework (no IFRS)	No mandated audit. The enterprise's accountant would certify the accounts.	

B. STRENGTHENING CAPACITY OF NATIONAL INSTITUTIONS

85. ***To ensure effective enforcement, provide regulators with adequate capacity, authority, and independence.*** Regulators should not be constrained by lack of appropriate human and financial resources. Costa Rica has already made progress in laying the institutional framework for high-quality financial reporting; this should be consolidated by further strengthening the enforcement mechanism, by increasing capacity of the regulators and granting them more authority in dealing with infractions of accounting and auditing standards.

86. ***Strengthen the CCPA through capacity building efforts.*** These efforts could assist the CCPA governance structure and enable it to fully comply with the IFAC Statements of Membership Obligation (SMOs). One specific way that CCPA could enhance its capacity is by establishing a twinning arrangement with a developed professional accountancy body. A strengthened CCPA would:

- function as an effective regulator of the accountancy profession in Costa Rica;
- make a deeper and broader effort at disseminating IFRS, IFRS for SMEs, ISAs, and other relevant standards to its members. This includes providing effective theoretical and practical training on IFRS, ISAs, and IESBA Code of Ethics to the auditors and staff of the regulatory bodies, so that they can ensure compliance with the applicable accounting, auditing, and ethics standards; and imparting or overseeing training to corporate sector accountants to build their technical capacity to prepare financial statements compliant with the required standards (or simplified reporting as the case may be);
- put in place arrangements for capacity strengthening of audit firms (particularly medium and small-sized firms) to implement the international audit quality standard (known as ISQC-1) issued by the IAASB of IFAC;⁵²
- complete development of its audit quality assurance review system, ensuring coordination in this effort with any similar activities of the various regulators; and
- facilitate access of audit firms (in particular medium and small-sized firms) to materials relating to recent developments in auditing practices, including the practical application of ISA and the IESBA Code of Ethics.

87. ***Update the CCPA's Code of Ethics based on the latest version of the IESBA Code of Ethics for Professional Accountants, and establish an ongoing process for the adoption and implementation of IESBA requirements.*** For purposes of ensuring adherence to ethical standards and independence of practicing auditors in line with international good practices, the CCPA should issue detailed guidance using local examples focusing on various issues covered by the IESBA code.⁵³ Guidance notes that

⁵² ISQC-1 requires all audit firms to implement a quality control system in accordance with the standards, and assists them in implementing these standards.

⁵³ The *Code of Ethics for Professional Accountants*, developed by International Ethics Standards Board for Accountants, which is an independent standard-setting body supported by IFAC, establishes ethical requirements for professional accountants and provides a conceptual framework for all professional accountants to ensure compliance with the five fundamental principles of professional ethics: integrity, objectivity, professional competence and due care, confidentiality, and professional behavior. Under the

cover actual cases can be prepared to illustrate issues that pose a threat to the auditor's independence in a Costa Rica-specific environment.

88. ***Encourage CCPR to work towards IFAC Membership by making progress with respect to the Statements of Membership Obligation (SMOs) requirements.*** To fulfill its mandate as a professional accountancy organization in line with international good practices, and to support the profession effectively, CCPR should initiate steps to become a member of IFAC and comply with its Statements of Membership Obligation, the scope of which includes the adoption and implementation of the IESBA Code, Investigation & Discipline, as well as pre- and post-qualification requirements. CCPR support to the implementation of IFRS, especially given that these standards are being increasingly applied in Costa Rica, would also more clearly establish its place within an updated accounting and auditing framework for Costa Rica. Absent this, CCPR will be seen largely as an association to preserve market rights rather than a true professional accountancy organization.

89. ***Upgrade the professional accountancy qualification requirements.*** The professional bodies (CCPA and CCPR) should enhance their entry and continuing education requirements by aligning with IFAC's International Education Standards. At entry, this should include a rigorous evaluation focused on education, experience and practical accounting and auditing skills (only for CCPA in the case of the latter), prior to being admitted as a member, in accordance with the International Education Standard 8, *Competence Requirements for Audit Professionals*. Ensuring that members maintain their skills and stay updated with current developments, including Continuing Professional Development requirements, is another priority. While some of these activities take place in Costa Rica, they need to be more comprehensive, formalized, and fully aligned with internationally accepted standards. One option is to work with other Central American countries toward a common professional accountancy qualification, which takes into account country-specific aspects.

90. ***Make an organized effort to improve IFRS and ISA teaching in universities and colleges.*** In order to ensure that theoretical and practical aspects of IFRS and ISA are included in the accountancy curriculum of all universities and colleges across the country, a centrally coordinated initiative is necessary for curriculum development and training the trainers. The professional accountancy bodies (CCPA and CCPR) could take the lead on this; another option could be to consider a center of excellence of accountancy training for organizing activities in this regard. In addition, an initiative should be taken to introduce "business ethics" as a separate compulsory subject in the undergraduate curriculum of all business-related disciplines; e.g. accounting, finance, management and marketing.

91. ***Establish an independent audit quality review program for the auditors.*** This could be done through a collaboration arrangement among the various regulatory bodies in Costa Rica and the CCPA. On the basis of the existing legal mandate of each of the

framework, all professional accountants are required to identify threats to these fundamental principles and, if there are threats, apply safeguards to ensure that the principles are not compromised.

participating regulatory bodies, the audit quality review mechanism should be developed to ensure high quality audit of financial statements of public interest entities (PIEs, including listed companies, financial sector entities, State owned enterprises, and other large companies). Quality assurance reviews can first be used as educational tools and then as an enforcement mechanism. There should be an efficient and effective procedure for taking disciplinary actions on a transparent basis against those found responsible for noncompliance with auditing standards and the code of professional ethics. Appropriate sanctions may include fines, penalties, and suspension or cancellation of the registration for providing auditing and related services to the regulated entities.

C. UPDATING THE LEGAL/STATUTORY FRAMEWORK

92. ***Modernize the legal framework for corporate financial reporting.*** Although the legal framework for the accountancy profession has been modified through the years, it still focuses on professional accountancy associations' organizational articulation and corporate rights and privileges rather than providing a comprehensive enabling framework for the high quality corporate financial reporting. It would be advisable to have a unique financial reporting law to replace the current fragmented framework. This would incorporate aspects relating to: (i) standards-setting; (ii) adoption and implementation of appropriate financial reporting and auditing standards (including for SOEs); (iii) enforcement; (iv) requirements for professional accountancy organizations and their members; and (v) quality assurance functions. Although establishing a new legal framework is a medium-term goal, and the reform could be implemented sequentially, it is considered vital to consolidating the ongoing efforts to fully meet international standards.

93. ***Financial reporting requirements for Public Interest Entities (PIEs).*** It is good practice for public interest entities to be defined, and for their financial reporting requirements to be specified, in the statute. PIEs would include listed companies, financial sector entities, State owned enterprises, and other large companies.⁵⁴ Legally backed arrangements should be put in place, including for the PIEs to adhere to financial reporting in accordance with IFRS, have ISA-compliant audits by CCPA members, and to disclose/publish audited financial statements. Oversight of PIEs with respect to accounting, auditing, and publication of audited financial statements would contribute to Costa Rica's competitiveness, enhance credit access, make accounting for tax purposes more consistent, and provide a spillover effect on other private companies.

94. ***Requiring statutory external audits for state-owned enterprises (SOEs)*** and publication of their audited financial statements is an important priority. SOEs' governance arrangements could also be adjusted in line with international best practices.⁵⁵

⁵⁴ For example, large enterprises could be defined as individual enterprises and groups of enterprises that meet any two of three thresholds based on: (a) total number of employees; (b) total assets on the balance sheet; and (c) turnover. The specific figures applicable should be determined by country stakeholders.

⁵⁵ For example: Organization for Economic Cooperation and Development (OECD): "OECD Guidelines on Corporate of State-owned Enterprises", December 2005.

ANNEX 1: MAJOR DIFFERENCES BETWEEN IFRS AND SUGEF (SUPERINTENDENCY OF BANKS) REGULATIONS

Some major differences were identified by accounting firms practicing in the country and partially confirmed as a result of our ROSC activities. Listed below are those considered more important in the light of the transactions normally carried out in Costa Rica. Certain practices, although at variance with IFRS are only briefly mentioned at the end of the list below either because they are not expected to have any important impact on the financial statements of financial entities or because the relevant IFRS rules are not yet mandatory. There are also cases where SUGEF prescribes practices basically in line with IFRS but fails to offer alternatives that international principles allow. These are not regarded as differences.

Standard	International practice	SUGEF regulation
IAS 1	Presentation of net results and balances is mandatory in certain cases, e.g. the result of the sale of financial instruments or income taken to the results of the period.	Net presentation is not allowed.
IAS 1	The revised version introduced a Statement of Comprehensive Income.	No such statement has yet been adopted by SUGEF.
IAS 12	Income arising from deferred income tax is taken to the income tax of the period.	SUGEF practices treat this item as a separate income item.
IAS 16	This standard indicates that property and other fixed assets may be either revalued with regularity sufficient to guarantee that valuation is in line with fair value or kept at cost.	SUGEF requires the revaluation of property at least every five years based on a professional appraisal. Other fixed asset items cannot be revalued.
IAS 16	The revaluation surplus may be transferred to retained earnings following depreciation of the relevant items or upon de-recognition.	SUGEF has permitted in certain cases the use of surpluses for capital increase.
IAS 18	Origination fees are treated as an adjustment of the effective interest rate of financial liabilities measured at amortized cost. Related costs may be deferred and absorbed separately over the period of the instrument depending on their nature.	Rather than treating them as separate items, SUGEF mandates the deferral of the excess of fees over related costs.
IAS 21	Functional currency is the currency of the primary economic environment in which the entity operates.	All supervised entities are expected to use the colón as the functional currency.
IAS 27	A parent must present consolidated financial statements, except in certain cases such as when the parent is itself a wholly-owned subsidiary, the group does not issue publicly traded instruments, etc. In these cases investments in subsidiaries should be valued at cost.	Regulated parents are required to issue non-consolidated financials where its investments in subsidiaries are stated at equity.

Standard	International practice	SUGEf regulation
IAS 27/28	IAS 27. Consolidation is based on the concept of 'control' and changes in ownership interests while control is maintained are accounted for as transactions between owners as owners in equity. Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed when the parent acquires more than half of the voting rights of the entity. Even when more than one half of the voting rights is not acquired, control may be evidenced by power. IAS 28. Applies to the equity method to investments in associates and joint ventures and defines an associate by reference to the concept of "significant influence".	In the case of financial groups designated as such, the parent must present consolidated statements including the financials of partially-owned companies if participation exceeds 25% independent of control. The 75% interest outside the group is presented as minority interest.
IAS 32	Under certain circumstances, the issuers of financial instruments shall classify these instruments as components of equity.	Classification under equity depends on local statutory rules.
IAS 37	Contingent assets cannot be recognized.	Provisions are required in case existing contingent assets value is expected to be lower than carrying value.
IAS 38	Organization and installation expenses are expensed currently.	These items may be capitalized and amortized over a period not in excess of five years.
IAS 39	Provision for non collectability of receivables is made when it is probable that, based on detailed analyses, relevant balances will not be received.	Rules issued by CONASSIF call for recording of provisions based on an arbitrary classification of receivables.
IAS 39	Several changes were introduced in the revised version of this standard in connection with the classification of financial instruments.	The changes introduced have not been implemented by CONASSIF (or SUGEf).
IAS 39	Certain classifications mandated by CONASSIF/SUGEf are either not contemplated or not mandatory under international standards.	Local rules indicate that no investments in financial instruments can be classified as held-to-maturity; certain investments can be classified as available for sale as long as there is an intention to dispose of them within a period not to exceed 90 days and prescribe the way participation in investment funds are to be shown.
IAS 40	Investments property may be recorded under the fair value or the cost models.	These assets must be stated at fair value unless there is evidence it cannot be reliably determined.
IFRS 3	This rule introduced various changes to the accounting for business combinations such as those that have to do with the definition of "business", the treatment of certain contingent items and the recognition of transaction costs.	These changes have not yet been adopted by SUGEf. This agency has also permitted in the past the use of procedures at variance with the purchase method.

Standard	International practice	SUGEF regulation
IFRS 5	This standard requires that non-current assets held for sale and discontinued operations be stated at the lower of cost or fair value (calculated as the discounted cash flows in the case of assets to be sold after one year).	Local standards mandate full provision for those assets not sold after two years.
IFRS 7	This standard has introduced refinements in the disclosures related to financial instruments. These changes deal with measurements of fair value and liquidity risk.	The contents of the international standard have not yet been adopted by CONASSIF/SUGEF.

Additionally, regulators have not yet adopted pronouncements such as IFRS 9 which brings about changes in the classification and measurement of financial instruments for periods initiated on or after January 1, 2013. Also, certain interpretations were ignored; however, they might not be expected to be widely applicable in the local environment.