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A Review of Accounting and Auditing Practices

Report on the Observance of Standards and Codes (ROSC)

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Main Abbreviations and Acronyms

A&A	Accounting and Auditing
CAP	Country Action Plan
CGRN	Office of the Comptroller General
CNA	Audit Standards Committee
CNC	Accounting Standards Committee
Colegio	Colegio de Contadores Públicos de Nicaragua
CPA	Certified Public Accountant
CPD	Continuing Professional Development
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GDP	Gross Domestic Product
GoN	Government of Nicaragua
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IES	International Education Standards for Professional Accountants
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
MFI	Microfinance Institutions
MHCP	Ministry of Finance and Public Credit
MUC	Unified Accounting Manual
NAGUN	Government Audit Standards
OECD	Organization for Economic Co-operation and Development
PIE	Public-interest Entity
PP&E	Property, Plant and Equipment
ROSC	Report on the Observance of Standards and Codes
SIBOIF	Superintendency of Banks and Other Financial Institutions
SME	Small and medium enterprise
SMO	IFAC Statement of Membership Obligations
SOE	State-owned Enterprise

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Executive Summary

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

ii. **Nicaragua remains among the poorest countries of the Western Hemisphere, with 46 percent of its five million people living below the poverty line.** The 2008 GDP of US\$6.4 billion translates into a per-capita GDP of approximately US\$1,000. After average GDP growth of about 3.6 percent during 2005–08, the global financial and economic crisis lead to a contraction in real GDP of 1.5 percent in 2009. Going forward, if the private sector is to serve as an engine of growth for the Nicaraguan economy, the country needs to follow high-level accounting and auditing practices and the highest standards of corporate governance.

iii. **This ROSC supports three main development objectives: (a) improving Nicaragua’s investment climate; (b) ensuring the stability and fostering the development of the local financial sector and (c) advancing governance and financial accountability in both the private and public sectors.** The report seeks to help the authorities address these issues by (i) improving the technical skills of accounting and audit practitioners, (ii) strengthening the regulatory framework governing accounting and audit practices in Nicaragua, and (iii) developing the institutional capacity of the country’s accounting professional bodies.

iv. **Nicaragua is converging with IFRS in its financial sector and moving toward adopting IFRS in other sectors.** Banks, insurance companies, and other financial entities supervised by the Superintendency of Banks and Other Financial Institutions (SIBOIF) are required to follow prudential standards, which are converging with IFRS but still contain important differences. Nicaragua has taken steps to require listed companies, state-owned enterprises (SOEs) and large borrowers to apply IFRS beginning in June 2011.² Other companies are not required to follow a specific accounting standard, although the IFRS for SMEs are being considered for future adoption.

v. **Overall, current accounting and auditing rules for SIBOIF-regulated entities in Nicaragua are adequate for supervisory purposes, although improvements are desirable in the medium term, as SIBOIF moves toward a risk-based approach.**

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

² Those companies are currently required to follow Nicaragua’s “Generally Accepted Accounting Principles,” a set of standards dating to the 1980s which would be replaced by IFRS as issued by the International Accounting Standards Board.

vi. **The quality of SME financial reporting tends to be quite low overall, and financial information produced in the real sector is insufficiently standardized. This raises a concern regarding the commercial banks' ability to properly monitor their credit risk exposures.** Outside of supervised sectors, Nicaragua does not have legally binding corporate financial reporting standards. Nicaragua's accounting professional body, the College of Public Accountants of Nicaragua, or *Colegio*, issues standards for its members. Currently, the *Colegio* requires its members to apply Nicaraguan GAAP. Yet most corporate accountants are not members of the *Colegio* and these standards are not binding upon businesses in any event.

vii. **Nicaragua's significant non-banking financial sector (microfinance institutions) is loosely regulated.** The system includes specialized microfinance banks, finance companies, two large financial cooperative movements and increasingly sophisticated nonprofit microcredit providers.

viii. **The financial reporting and audit processes within SOEs require significant improvement.** Some SOEs do not undergo any external audit. The Comptroller General's Office (CGRN) is responsible for auditing all government entities, but it has limited resources and in fact does not carry out audits of most SOEs. Moreover, CGRN's external audit review process as it is currently designed represents a significant bottleneck, preventing the public from receiving timely SOE financial statements.

ix. **Even though Nicaragua's accounting profession is unified under the *Colegio*, the latter suffers from governance and resource weaknesses which limit its capacity to execute its statutory functions and promote improvements in financial reporting and auditing practices.** To serve in the public practice (e.g., to sign audit reports), an accountant must be a member of the *Colegio*, which is the country's only accounting professional body. As a member of the International Federation of Accountants (IFAC), the *Colegio* is obligated to "use its best endeavors" to meet IFAC's seven Statements of Membership Obligations (SMOs), which represent good practice requirements for the profession. Unfortunately, the *Colegio* is not in compliance with most SMOs and is currently working with IFAC to draw up a compliance plan.

x. **The accounting education offered at most of Nicaragua's universities is not current enough to meet the needs of the profession and the business community.** Most Nicaraguan accounting graduates do not receive significant instruction in IFRS, ISA or other relatively recent yet critical developments. Across more than 50 universities, the quality of accounting curricula varies widely. Moreover, the lack of any ongoing evaluation or accreditation mechanism removes an important incentive for Nicaraguan universities and professors to continually update their curricula. An updated curriculum is particularly critical for accounting and auditing, since the profession's systems and practices have evolved rapidly with innovations in business and finance.

x. **Enforcement of A&A requirements is relatively consistent among SIBOIF-regulated entities and requires strengthening.** SIBOIF has significant enforcement capacity and regularly imposes public sanctions on supervised entities for failure to comply with A&A requirements. To further enhance its enforcement capacity, SIBOIF needs staff with significant IFRS expertise and comprehensive IFRS training.

xii. **Nicaragua lacks an independent audit oversight mechanism, which is considered a critical feature in the post-Enron environment.** Given that all regulatory entities and the public in general rely on the seal of quality that a clean audit opinion from a reputable auditor represents, it is necessary to ensure that this trust is not misplaced. Neither the *Colegio* nor any of the regulatory institutions have put in place any quality assurance procedures, and both SIBOIF's and CGRN's auditor registries need to be strengthened in order to ensure that all auditors of supervised entities are qualified. Currently, financial statement users can only rely on the major firms' internal quality assurance procedures, which are not transparent.

xiii. **Perceptions of the accounting and auditing profession within the business community are mixed.** The *Colegio* enjoys a good reputation as an institution among many professionals. However, there are doubts about the ability of Nicaragua's accountants to apply IFRS, especially those working in small firms or as sole practitioners. With respect to statutory audits, very few audit firms are regarded as credible players, outside of the "Big 4".

xiv. **Based on the above, significant improvements to Nicaragua's corporate financial reporting framework are needed in order for the country to meet its development objectives.** Bringing local A&A practices to par with international standards can only be a long-term objective. The principles underpinning reform efforts should include:

- *Enhancing cooperation between key players*—especially SIBOIF and the *Colegio*. Only through a collaborative approach can results be achieved.
- *Ensuring that whichever rule or standard is adopted is simple enough.* A case in point in that regard is IFRS for SMEs, which should be the standard of reference for the majority of companies in Nicaragua.
- *Developing adequate capacity.* A large-scale capacity-building effort led by the *Colegio* is likely to be necessary

xv. **Suggested short- and medium-term reform priorities are summarized in the table immediately hereafter.** Detailed recommendations will be finalized in consultation with the Nicaraguan authorities and in-country stakeholders during a workshop to be held in Managua.

Suggested Short- and Medium-term Reform Priorities

	“Quick Wins”	Medium-Term Priorities
Requirements	<ul style="list-style-type: none"> • SIBOIF prepares and publishes a map of the differences between SIBOIF MUCs and IFRS. • <i>Colegio</i> adopts IFRS for SMEs and decides on a definition of SMEs for financial reporting purposes. 	<ul style="list-style-type: none"> • GoN aligns its management of SOEs with OECD guidelines. • Microfinance Law is passed establishing a 2-tier regulatory scheme for MFIs.
Capacity	<ul style="list-style-type: none"> • Develop and implement an IFRS transition plan to provide a detailed roadmap for reform, regulatory harmonization and capacity development initiatives. • <i>Colegio</i> strengthens outreach to accounting departments at major universities with a view toward establishing an ongoing a curriculum upgrade. • <i>Colegio</i> reviews and adopts IFAC’s <i>Guide to Using International Standards on Auditing in Small- and Medium-sized Entities</i>. 	<ul style="list-style-type: none"> • SIBOIF implements IFRS training, aiming for a cadre of inspectors with significant IFRS expertise and general knowledge among all technical staff.
Enforcement	–	<ul style="list-style-type: none"> • <i>Colegio</i> lays groundwork for an audit quality assurance regime, building on similar efforts in Honduras and El Salvador.

I. Country Context

1. The review of corporate sector accounting and auditing (A&A) practices in Nicaragua has been carried out as part of the Reports on the Observance of Standards and Codes (ROSC) initiative. It was done under the aegis of Financial Sector Assessment Program (FSAP), in conjunction with the International Monetary Fund (IMF). The main focus of the ROSC review is the institutional framework and professional environment that underpin private sector accounting and auditing practices.³ The review also entailed a comparison of A&A standards mandated by the local legislation with the two benchmarks used for the reviews, International Financial Reporting Standards (IFRS⁴) and International Standards on Auditing (ISA⁵). The review did not cover government accounting standards and practices and the corresponding auditing issues.⁶

2. **Nicaragua remains among the poorest countries of the Western Hemisphere, with 46 percent of its five million people living below the poverty line.** The 2008 GDP of US\$6.4 billion equates to a per-capita GDP of approximately US\$1,000. The agriculture sector (led by coffee, sugar, cattle, and fishing) constitutes 17 percent of GDP while employing 40 percent of the population. Much of the services sector, which makes up 57 percent of GDP, remains at a nascent stage of development. The banking sector contributes approximately 5 percent of GDP, making it one of the smallest in Central America. After average GDP growth of about 3.6 percent during 2005–08, the global financial and economic crisis lead to a contraction in real GDP of 1.5 percent in 2009. The country is unlikely to achieve most of the Millennium Development Goals by the target date of 2015. In recent years, the Government of Nicaragua (GoN) has relied on official development assistance for approximately 30 percent of its budget.

3. **In this difficult environment, GoN has negotiated a three-year Poverty Reduction and Growth Facility Program with the IMF**—an important policy tool to continue to strengthen the country’s economy.⁷ In August 2009, the IMF announced that Nicaragua would receive US\$150.7 million in new special drawing rights as its part of the IMF’s worldwide anti-crisis package, which will help allow the Central Bank of Nicaragua to pursue a more expansionary monetary policy with a view toward a return to

³ For more information on the issues covered in the ROSC, and for a discussion of these challenges within a regional context, please refer to H. Fortin, A.C. Hirata Barros, and K. Cutler, *Accounting for Growth in Latin America and the Caribbean: Improving Corporate Financial Reporting to Support Regional Economic Development* (Washington, D.C.: The World Bank, 2010).

⁴ 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.

⁵ ISA are issued by the International Auditing and Assurance Standards Board, an independent board within the International Federation of Accountants (IFAC).

⁶ These issues were reviewed under the Public Expenditure Management and Financial Accountability Review conducted jointly by the World Bank and the Inter-American Development Bank.

⁷ In 2004, Nicaragua became the 10th country in the world to comply with conditions for debt relief under the Highly Indebted Poor Country (HIPC) initiative, leading to the forgiveness of more than US\$3 billion of public debt. Real GDP growth was 5.1 percent that year and was followed by several years of nearly 4 percent annual growth.

positive growth in 2010. Going forward, if the private sector is to serve as an engine of growth for the Nicaraguan economy, the country needs to follow high-level accounting and auditing practices and the highest standards of corporate governance.

4. **Most of Nicaragua’s regulated companies (banks, insurance companies, listed companies, and bonded warehouses) are supervised by the Superintendency of Banks and Other Financial Institutions (SIBOIF).** There are no private pension funds operating in Nicaragua. The fact that SIBOIF houses all financial regulators is a positive feature of Nicaragua’s corporate financial reporting framework. It helps to reduce the risk of overlapping jurisdictions, inconsistent application, and regulatory fragmentation, which can be a source of systemic risk in other countries.

5. **Nicaragua’s banking sector has grown significantly in the last few years.** Following a 2000–2001 banking crisis, banking sector supervision was tightened considerably and the financial sector experienced a significant period of concentration, consolidation, and growth during the next decade. Banking assets rose to nearly US\$4 billion by September 2009, compared with US\$2.7 billion in early 2006. Yet the sector remains small compared with most other countries in Latin America—there are just seven banks and two finance companies. Regional financial groups control approximately 83 percent of the banking sector assets; the rest is dominated by other foreign banks.

6. **Nicaragua’s securities exchange, similar to the case in other Central American countries, is not economically significant.** It includes five institutions that issue fixed-income instruments, ranging from short-term commercial paper to seven-year bonds.⁸ Compared to other exchanges in Latin America, its trading volume is low (approximately US\$500 million in 2008). To foster investors’ confidence in Nicaragua’s markets and enterprises, and encourage their willingness to invest, a strong corporate financial reporting framework to protect shareholders is essential.

7. **The insurance sector is poised to grow, once a new insurance law is approved.** The sector is relatively small, with only US\$166 million in assets as of August 2009, despite dozens of companies operating there. The new Insurance Law, currently under consideration in the parliament, will permit the entry of foreign insurance companies to the Nicaraguan market. It also aims to align the regulation of the insurance sector more closely with Solvency II principles.⁹

8. **Nicaragua’s microfinance sector is vibrant and deep—the most developed in Central America.** The system has evolved from one dominated by small, donor-supported microcredit nongovernmental organizations to a system led by specialized

⁸ The five are: Empresa Administradora de Aeropuertos Internacionales (state-owned airport management company), CREDIFACTOR, Central American Bank for Economic Integration, Central Bank of Nicaragua, and the Ministry of Finance and Public Credit.

⁹ Solvency II is the updated set of regulatory requirements for insurance firms that operate in the European Union. It is considered the international benchmark for good-practice insurance-sector regulation. Solvency II introduces economic risk-based solvency requirements, requiring insurers to hold capital against market risk, credit risk, and operational risk, in addition to the traditional insurance risks on which insurance-market supervisors have historically focused.

microfinance banks, two large financial cooperative movements and increasingly sophisticated nongovernmental microcredit providers. The microfinance loan portfolio accounts for 16.7 percent of the total financial system assets (up from 11 percent in 2003). Microfinance has attracted more than US\$300 million from international investors, fueling a 580 percent increase in the loan portfolio since 2003. Unregulated microfinance institutions (NGOs and financial cooperatives) represent 60 percent of the total loan portfolio of the sector. Banks and finance companies that offer microfinance are supervised by the banking supervisor.

9. **There are four bonded warehouse firms that are supervised as financial entities; they issue negotiable certificates of deposit based on collateral in the form of commodities, such as coffee or sugar.** At present, however, these certificates are not widely traded. Three out of the four bonded warehouses are owned by larger banking groups. The supervised bonded warehouse sector is small, representing combined assets of approximately US\$10.8 million.

10. **Nicaraguan state-owned enterprises (SOEs) are among the country's largest business entities.**¹⁰ The move toward privatization of SOEs that began in 1990 essentially ended in 2004, and the current administration is opposed to further privatization. State-owned enterprises are governed by specific Organic Laws, and are subject to audit by the Comptroller General's Office (CGRN). Strengthened financial oversight and corporate governance of SOEs is essential to ensure that these enterprises deliver adequate public services to citizens and local businesses in a fiscally sustainable manner.

11. **Nicaragua's key development challenges are to accelerate growth over a sustained period and ensure that its benefits are broadly shared.** To achieve these objectives, Nicaragua will need to maintain sound macroeconomic and fiscal policies, improve poverty targeting and efficiency of public expenditures, improve dramatically human capital formation, and expand economic opportunities for the poor by creating an enabling environment for investments and job creation.

12. **The Ortega administration's "National Human Development Plan 2008-2012 (PNDH)" is concerned with several issues discussed in this ROSC.** The administration's strategy seeks to strengthen small and medium enterprises, especially by enhancing their access to finance; improve public sector governance; and update the financial sector's legal framework, mainly pertaining to capital markets, insurance, and trusts.

13. **The Bank's Country Partnership Strategy (CPS) for Nicaragua (FY08-12) is aligned to the Government's priorities and is structured around support for four strategic objectives:** (i) reactivating the economy, stimulating productivity and

¹⁰ They include, among others, the Nicaraguan Electricity Company (ENEL), the International Airport Administration Company (EAAI), the Nicaraguan Insurance and Reinsurance Institute (INISER), the Nicaraguan Petroleum Distribution Company (PETRONIC), and the Nicaraguan Water and Sewerage Company (ENACAL).

competitiveness; (ii) human capital development by improving social equity and opportunity; (iii) infrastructure and sustainable development; and (iv) strengthening governance and accountability by modernizing state institutions and promoting citizen participation. The quality of A&A practices in Nicaragua is important for both the private and public sectors, in that both sectors need trusted, reliable enterprises that can drive the country's economic growth.

14. **Based on the above, this ROSC A&A for Nicaragua pursues three main strategic objectives, which are aligned with the 2008-12 CPS.** The strategic objectives are: (a) enhancing financial sector supervision through improved accounting and auditing; (b) working to expand SME finance through improving available financial information; and (c) advancing governance and financial accountability in both the public and private sectors in order to improve the business climate. This ROSC seeks to help the authorities achieve these objectives, in particular through (i) designing a solid and workable regulatory framework governing the accounting and audit profession in Nicaragua, (ii) improving the technical skills of accounting and audit practitioners, and (iii) enhancing the institutional capacity of the country's accounting professional bodies.

II. Institutional Framework for Corporate-sector Accounting and Auditing

A. Statutory Framework

A.1. Enterprise Sector (excluding SOEs)¹¹

15. **Nicaragua's Code of Commerce, as amended, requires all companies to prepare annually a balance sheet and an inventory and publish it in the Official Gazette.**¹² The Nicaraguan legal system is based on Spanish Civil Law. Companies in Nicaragua are most commonly organized as corporations (*Sociedad Anónima*, or S.A.), which are governed by the Code of Commerce of 1914. Companies can also be organized as limited-liability companies (*Sociedad Colectiva de Responsabilidad Limitada*, or S.R.L.), which are also governed by the Code of Commerce.¹³ Provisions of the Civil Code, which dates back to 1904, also cover companies. Other financial reporting obligations are covered under the tax code (especially the 2003 Tax Equity law, as amended). There are no fines specified for not maintaining books of accounting. Other financial statements in addition to a balance sheet (i.e., income statement, statement of cash flows, and statement of changes in equity) or explanatory notes are not explicitly required by statute.

¹¹ For purposes of this report, "enterprise sector" refers to all commercial organizations (companies) operating outside the financial sector (i.e. other than banks, insurance companies, pension fund administrators, or other providers of financial services).

¹² Code of Commerce, Article 248.

¹³ A World Bank project is currently underway to modernize the Code of Commerce.

16. **Nicaragua does not have legally binding corporate financial reporting standards.** Nicaragua’s accounting professional body, the *Colegio de Contadores Públicos de Nicaragua* (the College of Public Accountants of Nicaragua, or the *Colegio*), issues standards for its members. Currently, the *Colegio* requires its members to apply Generally Accepted Accounting Principles in Nicaragua (Nicaraguan GAAP, or “PCGA”). Yet most corporate accountants are not members of the *Colegio* and these standards are not binding upon businesses in any event.

Table 1: Overview of Accounting and Auditing Requirements in Nicaragua

Type of entity	Regulatory Agency	Accounting Standards	Audit Requirements	Publication
Banks and finance companies	SIBOIF	SIBOIF Unified Accounting Manual (MUC) for banks	Yes; auditor must be registered with SIBOIF. New audit team every 3 years	Complete audited financial statements must be published on regulated entity’s website.
Listed companies		NI-GAAP/IFRS/US-GAAP*		
Insurance companies		SIBOIF MUC for insurance companies		
Bonded warehouses		SIBOIF MUC for bonded warehouses		
Microfinance NGOs and cooperatives	INFOCOOP for cooperatives; none for NGOs	None	None	None
State-owned / public enterprises	CGRN and sector-specific agencies	None ¹⁴ ; most SOEs follow “PCGA” (Nicaraguan GAAP), or a modified version thereof.	Subject to CGRN audit; may request an external audit by a private firm. New audit firm every three years.	External audit reports are publicly available only after CGRN approval. Currently, there is a 5-7 year backlog.
Other non-listed companies	None	None ¹⁵	For borrowers who take out loans > US\$300,000: certified financial statements; for loans >US \$750,000: audited financial statements	Corporations must publish their annual, unaudited balance sheet in the Gazette

* See paragraph 76.

17. **Beginning in 2009, SIBOIF requires banks to collect audited financial statements from all companies that borrow more than US\$750,000 (or its equivalent in Córdoba).** All companies borrowing between US\$300,000 and US\$750,000 must

¹⁴ Accounting standards are sometimes specified in the Organic Law of a given SOE

¹⁵ See Para. 16.

submit “certified” financial statements to their lending institution.¹⁶ The SIBOIF resolution does not specify a particular auditing standard, although it does require the auditor to be an Authorized Public Accountant.¹⁷ Also, the Fiscal Equity Law on taxation requires taxpayers to submit the same financial statements to banks for the purposes of obtaining credit that they submit to tax authorities.¹⁸

18. **Similar to accounting standards (Para. 16), the *Colegio* issues auditing standards that are binding upon its members.** The *Colegio* adopted International Standards on Auditing (ISA) in 2003. Membership in the *Colegio* is required to practice as an Authorized Public Accountant and, by extension, to sign audit opinions. The *Colegio*'s requirement that audits be carried out under ISA therefore has indirect legal standing.

19. **Publication requirements for non-financial, non-listed companies are in line with or exceed common practice in the Latin American and Caribbean (LAC) region.** The Code of Commerce requires all corporations (S.A.) to publish an unaudited annual balance sheet in the Gazette. Enterprises are required to hold annual general meetings (AGM) of shareholders, at which the balance sheet is reviewed and approved.¹⁹ Companies are not required to place their financial statements with the public registry (*Registro Público*), as is required in a number of other countries.²⁰ Such a provision involves some practical difficulties, such as the difficulty of enforcement, but it should be considered good practice.

20. **Every company must appoint at least one “inspector” (“vigilante”), or a “consejo de vigilancia,” which performs an internal control function similar to, but more limited than, an internal auditor.** The inspector, who may or may not be a shareholder, and who is elected by the shareholders at the AGM, reviews the balance sheet and inventory for any discrepancies or irregularities. Inspectors can only be held liable for failure to execute their duties, not necessarily for failure to detect discrepancies or irregularities.²¹

21. **No provision of company or tax law requires non-listed enterprises that control a group of enterprises to prepare consolidated financial statements.** Nor do the laws make any distinction between consolidated and legal entity financial statements.

¹⁶ The law does not define “certified” financial statements, but Nicaraguan audit firms clarify that a certification, as they have interpreted it, is a type of review that essentially verifies that the financial statements agree with the books of accounts. This review does not rise to the level of an audit.

¹⁷ SIBOIF standard on Credit Risk Management, Resolution No. CD-SIBOIF-547-1-AGOST20-2008, Annex 1, August 20, 2008.

¹⁸ Fiscal Equity Law (Law No. 453 of 2003, as amended by Law No. 528 of 2005), Article 137

¹⁹ Code of Commerce, Articles 248, 251, and 257.

²⁰ Latin American and Caribbean countries that have introduced similar requirements include Argentina, Brazil (for corporations), Colombia, Guyana, Mexico, and Uruguay. El Salvador requires publication of a balance sheet. Filing of annual accounts by all private commercial companies is a very common practice in Europe.

²¹ Code of Commerce, Articles 246, 293, and 295.

A.2. Banking Sector

22. **Nicaragua's banks are subject to relatively high standards of financial reporting and prudential requirements although they fall short of IFRS in several important respects.** Banking-sector accounting standards are codified in SIBOIF's Unified Accounting Manual (MUC) for banks (see Section III, Accounting Standards as Designed and as Practiced – para 74). Banks are required to submit audited financial statements to SIBOIF's Banks department within 90 days following the close of the fiscal year.²² The annual financial statements must include a balance sheet, an income statement, a statement of changes in equity, a cash flow statement and notes that include the most important accounting policies and other explanatory notes.²³ Financial groups must also present quarterly unaudited consolidated financial statements to SIBOIF within 30 days after the end of each quarter, and audited consolidated financial statements within 90 days of the close of the fiscal year.²⁴ All banks must present monthly reports containing assets, liabilities, earnings and prudential information. SIBOIF may also request financial information from any other entity that is part of the same economic group as a regulated bank.

23. **SIBOIF publication requirements for the banking sector are in line with good international practice.** Within 120 days after the end of the fiscal year, banks are required to publish their audited annual balance sheet, income statement and the auditor's report in a national circulation newspaper and the Gazette.²⁵ Banks must also publish their *complete* annual audited financial statements, with the accompanying notes, on their websites. When they are part of larger groups, banks should also include a note on their websites directing financial statement users to the consolidated group financial statements.²⁶ SIBOIF publishes the unaudited monthly balance sheets and income statements on its website.

24. **Similarly, statutory audit requirements in the banking sector are broadly in line with good international practice except for the fact that no sector-specific expertise is required.** Banks must appoint external auditors who are registered with SIBOIF's external auditor registry and must notify SIBOIF of their appointment or dismissal. Statutory audits must be carried out under ISA, and the financial statement audit reports must be accompanied by supplemental information on internal controls, information systems, and anti-money laundering/combating the financing of terrorism (AML/CFT) prevention mechanisms. Banks must rotate their external auditing team, including the signing partner (though not necessarily the entire firm) and all specialized

²² SIBOIF standard on External Audit, Resolution No. CD-SIBOIF-583-2-ABR29-2009 of April 29, 2009, Article 40.

²³ SIBOIF standard on External Audit, Resolution No. CD-SIBOIF-583-2-ABR29-2009 of April 29, 2009, Article 23.

²⁴ SIBOIF standard on Financial Groups, Resolution No. CD-SIBOIF-516-1-ENE9-2008 of January 9, 2008, Article 28b.

²⁵ General Law on Banks, Non-banking Financial Institutions and Financial Groups, Law 561 of 2005, Articles 24, 116, and 128.

²⁶ SIBOIF standard on External Audit, Resolution No. CD-SIBOIF-583-2-ABR29-2009 of April 29, 2009, Article 41.

personnel related to the audit, every three years. The latter rotation period is relatively short, especially if compared with US or European equivalent requirements.²⁷ One apparent weakness in the regulatory framework is that SIBOIF does not have the right to exclude an audit firm for lack of experience auditing financial institutions.²⁸ The authority to exclude unqualified audit firms is meant to ensure that external auditors of banks meet minimum “fit and proper” conditions. At present, there are just six audit firms registered with SIBOIF, four of which are affiliated with large, international audit networks. As a precaution, therefore, the requirements to serve as a statutory auditor should be clarified and strengthened to ensure that all registered audit firms have a sufficient number of experienced staff to audit SIBOIF-supervised entities.²⁹

A.3. Insurance companies

25. **Nicaragua’s insurance companies must comply with most of the same general requirements as banks, but the insurance-specific provisions have not yet been updated to reflect Solvency II principles** (Footnote 9). SIBOIF’s Insurance department requires regulated entities to submit complete audited financial statements annually within three months of the close of the fiscal year. These financial statements must be prepared using SIBOIF’s MUC for insurance companies. (Section III, Accounting Standards as Designed and as Practiced.) In addition, SIBOIF requires companies to submit monthly balance sheets and income statements, as well as information on reserves, investments and solvency margins. The Insurance Law dates back to 1970, and as such does not reflect Solvency II principles of risk-based supervision.³⁰ An updated insurance law is currently under consideration in the National Assembly.

26. **SIBOIF insurance-sector publication and audit requirements are identical to those of the banking sector and are in line with good practice.**

A.4. Other financial entities

27. **Bonded warehouses are subject to most of the same SIBOIF requirements as described for banks and insurance companies.** Bonded warehouses are required to submit financial reports to SIBOIF’s bonded warehouse department on the same schedule, which includes audited annual financial statements within three months of the end of the fiscal year. Bonded warehouses have their own MUC, which differs from IFRS

²⁷ SIBOIF standard on External Audit, Resolution No. CD-SIBOIF-583-2-ABR29-2009 of April 29, 2009, Article 41.

²⁸ It should be noted that Article 12 of the SIBOIF standard on External Audit (Resolution No. CD-SIBOIF-583-2-ABR29-2009 of April 29, 2009) requires supervised financial institutions to select an external auditor “with sufficient experience, infrastructure, human and technical capital, and adequate qualifications for the volume and complexity of operations that the audited financial institution undergoes.” Nonetheless, this places the responsibility of evaluating the external auditor’s qualifications with the supervised institution, when it properly should rest with SIBOIF.

²⁹ Typically, new entrants to this market are audit firms that have been formed by partners with prior experience carrying out statutory audits for supervised entities. Therefore, the existence of so-called “fit and proper” requirements does not prevent new firms from competing.

³⁰ General Law on Insurance Institutions, Decree 1727 of August 4, 1970.

in much the same way as the prudential standards for other sectors. (See Section III, Accounting Standards as Designed and as Practiced.) Bonded warehouses must (a) select an external audit from SIBOIF's audit registry, (b) rotate all members of the audit team every three years and (c) publish their complete audited financial statements on their websites, as other SIBOIF-regulated entities also do.

28. Microfinance institutions (MFIs) are subject to different levels of supervision depending upon their mode of incorporation. A few MFIs are “finance companies” that offer microfinance as well as consumer and SME lending. These larger MFIs, which comprise approximately 40 percent of the total microfinance loan portfolio, are supervised by the SIBOIF and are subject to the same requirements as banks. The remaining 60 percent of the sector (as measured by loan portfolio) consists of financial cooperatives and NGO MFIs and is essentially unregulated. Financial cooperatives are loosely supervised by the government's cooperative authority, the Nicaraguan Institute for Cooperative Development (INFOCOOP). MFIs are required to submit financial statements to INFOCOOP within 30 days after the end of each fiscal year.³¹ The Cooperatives Law also explicitly grants “autonomy in the design and execution of operational policies” to financial cooperatives, which may impede or preclude prudential supervision of these entities.³² Some NGO-type MFIs belong to the Nicaraguan Microfinance Association (ASOMIF), which requires its members to submit unaudited annual balance sheets and income statements for publication in ASOMIF's annual report. These data are primarily for statistical purposes, however, and ASOMIF does not review its members' financial statements or provide oversight.

A.5. Securities market participants

29. Entities associated with Nicaragua's stock exchange are supervised by SIBOIF and are subject to similar financial reporting and oversight requirements as other SIBOIF-regulated entities. Similarly, publication and audit requirements for listed companies are the same as other SIBOIF-regulated companies (Para. 23-24).

30. SIBOIF has recently issued a mandatory corporate governance for listed companies which require them to set up an audit committee. All companies that issue securities must form an audit committee of at least two board members, at least one of whom must have at least a bachelor's degree in accounting or business administration and at least five years of experience in financial accounting. Independent members of the audit committee are permitted but not required. The audit committee is responsible for supervising the inspector or internal auditor and to propose an external auditor to the Board of Directors, among other duties. The corporate governance standard also requires clear internal controls policies and a code of ethical conduct.³³ These corporate

³¹ General Law on Cooperatives, Law No. 499 of January 25, 2005, Article 108. Neither the law nor the regulation further defines “financial statements” to specify which financial statements are required.

³² General Law on Cooperatives, Law No. 499 of January 25, 2005, Article 14: “*Las cooperativas de ahorro y crédito, en su actividad de brindar servicios financieros a sus asociados, gozarán de autonomía en la concepción y realización de su política de operaciones.*”

³³ SIBOIF standard on Corporate Governance for Issuers of Publicly Traded Securities, Resolution CD-SIBOIF-559-2-NOV5-2008 of November 5, 2008.

governance requirements are weaker than those that prevail in Europe, the US, Chile, or Brazil. On the other hand, some countries in the region (e.g., Panama) have a comprehensive code of corporate governance that is nonetheless *voluntary*, whereas Nicaragua’s code has the force of law.

A.6. State-owned enterprises (SOEs)

31. **Most SOEs in Nicaragua are not subject to good-practice corporate financial reporting and auditing requirements.** SOE financial reporting and audit requirements are contained primarily in the public administration laws and regulations. SOEs, like all government ministries and agencies, prepare their financial information according to the standards described in the Government Accounting Manual and submit monthly financial information to the Ministry of Finance and Public Credit (MHCP), which is responsible for the national budget and its execution.³⁴ The MHCP posts the annual national budget on its website, but quarterly and annual financial statements are not publicly available for any government entity. In sum, Nicaraguan SOEs are for the most part treated as merely another government department, rather than as businesses run by the state in the interest of the public. The OECD *Guidelines on Corporate Governance in State-Owned Enterprises* recommend that SOEs “be subject to the same high quality accounting and auditing standards as listed companies.”³⁵ Additional SOE A&A requirements may be established in the specific organic law that establishes each SOE.³⁶

32. **SOEs are not required to undergo an annual financial statement audit.** CGRN is responsible for auditing all government entities, but it has limited resources and in fact does not carry out audits of most SOEs. Instead, it primarily carries out so-called “special audits” in response to a specific citizen accusation or a news report claiming misuse of public funds. When CGRN does carry out an audit, it is done under Nicaragua’s Government Audit Standards (NAGUN), which are focused on ensuring budgetary compliance rather than on performing an independent audit *per se*. There is no requirement for SOEs to undergo external audits, although some do so based on their obligations as recipients of donor funds, based on a decision by management, or because the SOE is supervised by SIBOIF. These audits are carried out by private audit firms and are typically carried out under “NAGUN and ISA.”

33. **CGRN’s external audit review and approval process represents a significant bottleneck preventing the public from receiving timely financial information about SOEs.** After an external audit has been completed, the audited financial statements must be submitted to CGRN for approval to be released to the public. This final step may take five or more years to complete. For example, the Nicaraguan Electric Company’s (ENEL) 2002 financial statements, with an audit report dated December 15, 2003, were

³⁴ Law on the Organization, Responsibility, and Procedures of the Executive Branch, Law 290 of June 3, 1998, and its regulations.

³⁵ Organisation for Economic Co-operation and Development. 2005. *Guidelines on Corporate Governance of State-Owned Enterprises*. Paris: OECD.

³⁶ Five SOE organic laws that the ROSC team reviewed (including the water and sewage authority, the port authority, the international airport, the electrical transmission company, and the national insurance company) did not contain specific accounting or auditing requirements.

approved for public release by the CGRN on October 9, 2008. Even after they have been approved, the audited financial statements are only available through a formal request to CGRN. Most of Nicaragua's SOEs do not publish their audited financial statements online (Nicaragua's International Airport Administration Company, EAAI, is an exception in this respect because it is listed on the Managua stock exchange).

B. The Accounting and Audit Profession

34. **The legal framework for the accounting/audit profession in Nicaragua contains some positive aspects, but lacks key requirements introduced in the post-Enron era in many other jurisdictions.** The profession in Nicaragua is regulated by a specific law, the Law on the Accounting Profession of 1959.³⁷ This law created the *Colegio de Contadores Públicos de Nicaragua* (the *Colegio*) and that organization remains the country's only accounting professional body. To work as an accountant in the public practice (for example, to sign audit reports or tax declarations), one must join the *Colegio* and fulfill other requirements to become a licensed accountant (Para. 39). To work as an accountant for a private business or for the government, however, one does not need to be a *Colegio* member. The Accounting Law lacks certain provisions—such as a multidisciplinary accounting and auditing standard-setting authority and an independent auditor oversight board—that have come to be viewed as essential elements of a modern A&A framework, especially in light of well-publicized accounting failures and frauds in the last decade.

35. **Some of the *Colegio*'s institutional strengths allow it to compare favorably to many of its peers in Central America.**

- i. It does not compete with any other accounting professional body for members, and it draws active members from the diverse branches of the profession, including large audit firms, sole practitioners, and academia. This level of unity in the profession is fairly uncommon in the region;
- ii. It has better financial resources than its peers in many other small countries.³⁸ The legal requirement of mandatory affiliation to the *Colegio* allows it to collect dues from its members. The *Colegio* charges new affiliates 900 NIO (approx. \$45) to join and collects annual dues of 1,440 NIO (\$72). At the same time, the *Colegio*'s dues alone are not enough to cover its expenses: despite listing 2,076 active members as of May 31, 2009, fewer than 10 percent (125) were up to date with their monthly dues. The *Colegio* therefore seeks sponsorships from the large audit firms, corporations, and individuals. It also earns revenues from its CPD seminar program; and
- iii. Its management is sound enough to know with precision how many members are behind in their dues payments, how many still practice, how many are retired, how many live outside of the country, how many are deceased, etc. This

³⁷ Law on the Practice of Public Accounting, Law No. 6 of April 14, 1959.

³⁸ The *Colegio*'s audited financial statements for the year ending May 31, 2009 report total of \$215,000 and net income of \$15,000, with cash on hand and at bank totaling \$95,000.

seemingly basic level of organizational management is missing in many of the *Colegio's* peer institutions in other small countries in the region.

36. **However, a significant weakness of the 1959 Accounting Law is that it mandates annual elections for the *Colegio's* Board of Directors and prohibits any official from serving in the same position for two consecutive years.** This creates a severe governance challenge for the *Colegio*, as its leadership turns over annually. The law not only causes the *Colegio* to lose significant institutional memory each year, but also it makes the execution of long-term projects to improve the Profession exceedingly difficult to execute.

37. **The *Colegio* is a member of the International Federation of Accountants (IFAC), and as such is obligated to “use its best endeavors” to meet IFAC’s seven Statements of Membership Obligations (SMOs).** Currently, the *Colegio* is not in compliance with most SMOs and is currently working with IFAC to draw up a compliance plan. (Table 2)

38. **Requirements for entry into the profession are higher than in many LAC countries, but nevertheless fall short of IFAC’s International Education Standards for Professional Accountants (IES).** To be admitted as an Authorized Public Accountant of Nicaragua (or “CPA (Nicaragua)”³⁹), one must: (a) be a member of the *Colegio*; (b) possess a university degree with a specialization in accounting; (c) have two years of relevant accounting experience; and (d) obtain and maintain a 5,000 NIO (approx. US\$250) insurance policy. IES requires sufficient higher education in accounting, at least three years of professional experience under an experienced mentor, and the passing of a final exam for all licensed professional accountants.

39. **Continuing professional development (CPD) is not mandatory for members of Nicaragua’s profession, which is a serious weakness.** The *Colegio* offers some voluntary continuing professional development (CPD) courses, typically one or two per month. Implementing mandatory continuing professional development is required of the *Colegio* by IFAC under SMO 2, and is clearly good practice for any accounting professional body. The draft revised accounting law would require licensed accountants to complete 40 hours of CPD per year in order to renew their licenses. One intermediate step toward implementing a CPD program is to offer a certificate to accountants who voluntarily complete 40 hours per year of CPD. By comparison, Panama’s *Colegio de Contadores Públicos* has implemented such a program successfully.

40. **The current code of ethics, in force since 1996, is not as comprehensive as IFAC’s Code.** IFAC’s Code, more than 90 pages long, includes a broad risk-based framework and specific examples to guide members of the Profession in navigating ethical conflicts that are not covered explicitly in the Code. The *Colegio's* Code, at 32

³⁹ Nicaragua refers to its licensed public accountants as “CPAs,” however we refer to them herein as CPA (Nicaragua) to avoid confusion with the US-based CPA certification, which is recognized internationally. Only licensed accountants may sign audit reports or to provide assurance services to the public, but accountants need not be licensed to work as an accountant in industry or in government.

pages, is less comprehensive and is not recent enough to incorporate the lessons learned from the series of accounting-related scandals, of which Enron is the best known. Aside from being an example of good practice, the adoption of IFAC's Code is among the seven SMOs that IFAC requires its member bodies (including the *Colegio*) to follow.

41. **Nicaragua's licensed accountants are required to obtain professional indemnity insurance, but the value of the policy is too small to be meaningful.** 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. Nicaragua's current accounting law requires licensed accountants to buy a policy that insures them for up to 5,000 NIO (approx. US\$250) in damages and liability (or, to certify tax declarations, triple that amount). While the draft accounting law would increase this amount five-fold, even this higher amount is likely not sufficient to cover legal expenses and damages stemming from a claim (or claims) of liability due to an accountant's negligence.

Table 2: Compliance with IFAC Statements of Membership Obligations (SMOs)

SMO No.	Issue Covered by SMO	Comments	Ref.	Compliance with SMO
1	Quality Assurance	No quality assurance mechanisms currently implemented; they are mentioned in the draft new accounting law	Para. 67	None
2	International Education Standards for Professional Accountants (IES) related guidance	- College degree and 2 years relevant experience required for accounting license. - Curriculum standards not up to IES. - No entry examination - No CPD requirement.	Paras. 37, 38, 41	Low
3	ISA and related	- ISA adopted by the <i>Colegio</i> in 2003 - No implementation regulations issued	Para. 55	Partial
4	IFAC Code of Ethics for Professional Accountants	Nicaragua's code of ethics dates to 1996 and is not as comprehensive as IFAC's.	Para. 39	Low
5	International Public Sector Accounting Standards and related guidance	CGRN's Government Accounting Manual is based on Nicaraguan PCGA; there are no programs aimed at convergence with IPSAS.	Para. 30	None
6	Investigation and Discipline	The <i>Colegio</i> 's Honor Council only investigates failure to pay dues or specific ethical complaints; sanctions are exceedingly rare.	Para. 56	Low
7	IFRS	- <i>Colegio</i> requires Nicaraguan GAAP - IFRS is to be applied beginning in 2011 - No regulations or steps toward IFRS implementation issued by <i>Colegio</i> .	Paras. 16, 68	Substantial on paper

A more general problem is that the amount of required professional indemnity insurance has been written into statute, both in the current law and in the proposed new accounting law. A better practice is to require professional indemnity insurance in the law, but specify the amount of required coverage in the accompanying regulation. In this way, the amount of coverage can be revised over time without requiring legislative action to amend the law.

42. **A proposed new Law on the Accounting Profession has been drafted by the Colegio and submitted to the National Assembly; it proposes significant improvements to the old law but still leaves much to be desired.** On the positive side, the law seeks to bring the requirements to be a licensed accountant into line with IES, by requiring an examination of professional competence, three years of prior experience, and an ongoing program of 40 hours per year of continuing professional development (CPD). It also requires licensed accountants to undergo a quality control review at least once every three years in order to renew their license. All of these requirements are in line with high-quality international standards for certification of public accountants. The law also increases the amount of the required insurance policy to 25,000 NIO (approximately US\$1,250) or, to certify tax declarations, 100,000 NIO (US\$5,000). Finally, it extends the terms of the elected Board of Directors, including the president, to 2 years, while again preventing their reelection to the same position in consecutive elections. For these last two reforms, international experience has shown that it is better to avoid including such specifics in the law itself, but rather to include these details in the regulations, so that they may be modified more easily.

43. **The proposed new accounting law would also significantly limit competition, and reserve functions and privileges to the profession in a way that is likely to make the law unpalatable to many segments of the business community and academia.** Specifically, the draft law proposes, *inter alia*, to:

- a) Charge a sliding stamp-tax, from 50 NIO to 1,000 NIO (US \$2.50 to \$50) depending on the assets of the given entity, for audit or certification of financial statements;
- b) Prohibit the hiring of non-CPAs (Nicaragua) to supervisory positions in government or academia that have to do with accounting or auditing (a list of specific positions and general types of positions to be reserved for CPAs (Nicaragua) is included in the draft law);
- c) Prevent foreign accountants or firms from practicing without a Nicaraguan firm or individual CPA (Nicaragua) co-signing (and taking responsibility for) their work;
- d) Shift responsibility for designing university accounting curricula from the universities to the *Colegio*; and
- e) Create an accounting and auditing standard-setting authority composed exclusively of members of the *Colegio* whose standards would be binding upon businesses.

44. **The fact that this law was drafted by the Colegio alone, without consulting other sectors, helps to explain the law's tendency to reserve privileges for the profession, even when these are not necessarily in the broader public's interest.** The lack of outside consensus may also help to explain why the proposed new law has not been brought up for formal consideration by the National Assembly since it was submitted in July 2008.

45. **In line with most other Latin American countries, the larger audit firms, mainly the "Big-4", make a significant contribution toward establishing audit quality and promoting IFRS-compliant financial reporting, supplementing the Colegio's role.** Because they are affiliated to the large global audit networks, the Nicaraguan member firms (or, to a lesser extent, associated firms), can tap into the broad and deep pool of IFRS and audit expertise that the networks have developed, to train preparers, regulators and students.

C. Professional Education and Training

46. **Public accounting is one of the most popular courses of study in Nicaragua's fast-growing higher education sector.** As of October 2009, there were 53 approved universities in the country, educating approximately 125,000 students.⁴⁰ This represents a rapid expansion from just 10 universities in existence prior to 1990. The National Autonomous University of Nicaragua at Managua (UNAN-Managua), one of Nicaragua's four national public universities, is the largest university in the country with 27,452 students as of 2008. The next largest institution is the country's oldest: the National Autonomous University of Nicaragua at León (UNAN-León), which has 15,900 students. Public accounting is one of the most popular courses of study where it is offered. For instance, at UNAN-Managua in 2008, public accounting (with 1,108 students pursuing this major) is the second-largest major after medicine.⁴¹

47. **Most Nicaraguan accounting graduates do not receive significant instruction in IFRS, ISA or other relatively recent yet critical developments.** The ROSC team reviewed the curricula and syllabi for the public accounting degree at the largest private and public universities, comparing the curricula to international benchmarks of good practice.⁴² At both universities, IFRS are taught in a single course during the four or five-year program. Likewise, ISA are taught in a single course. Given the complexity of these international standards (IFRS runs to nearly 3,000 pages) and their nearly worldwide adoption, this is not sufficient class time for comprehensive instruction in the material. The largest public university's accounting curriculum contains most of the other essential elements, but lacks instruction in corporate governance, information systems, and basic business English—all of which are critical for a modern accounting education. The largest private university offers instruction in most recommended areas, with the exception of corporate governance, a subject that has grown in importance during the last decade.

⁴⁰ Ludwin Loáisiga López, "Diputados: CNU no autorizará más apertura de universidades," *Diario La Prensa*, October 8, 2009. <http://archivo.laprensa.com.ni/movil/diputados-cnu-no-autorizara-mas-apertura-de-universidades-13223.html>.

Carlos Olivares, "Nicaragua: New Private versus Old Private and Public," *International Higher Education*, No. 45, Fall 2006, pp. 14-15.

⁴¹ National Universities Council, <http://www.cnu.edu.ni>.

⁴² The model curriculum of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (UNCTAD-ISAR), available at <http://www.unctad.org/isar>, and IFAC's IES, available at <http://www.ifac.org>.

48. **There is no supply-side or demand-side mechanism to ensure high-quality curricula and well-qualified professors, especially among the newest, private-sector institutions.** On the supply-side, the Law on the Autonomy of Institutions of Higher Education, passed in 1990, gives the National Universities Council (CNU) the authority to approve new universities, but not the authority to implement an ongoing accreditation or curriculum evaluation program.⁴³ The lack of any ongoing evaluation and accreditation mechanism removes an important “supply-side” incentive for universities to continually update their curricula. Another way to incentivize improvements in higher education is to promote the “demand side” by giving more students a reason to choose the universities that prepare them best. In other countries, an accounting “certification” process has induced such demand, by offering a special certification to those students who are able to pass a rigorous examination, apprenticeship, and other requirements. Students seeking such a credential tend to choose the university that will best position them to pass the examination, or to advocate for upgrades in their university to prepare them adequately. A supply or demand-side incentive to continually improve accounting curricula is important given the continuous changes in the subject matter.

49. **The quality of accounting education provided by Nicaraguan universities is uneven and requires significant improvement.** The rapid growth in tertiary education during the last two decades, coupled with the lack of a mechanism to ensure up-to-date curricula and high-quality accounting professors, has led to a high level of variation in the quality of tertiary education. Employers have strong views on the relative quality of the various universities. Private- and public-sector professionals with whom the ROSC team spoke reported that the level of preparation among graduates of the largest and oldest universities was far better than what could be expected from most of the newly founded universities. Given that a university education in accounting, from any institution, is the primary prerequisite an accounting license, the proliferation of lower-quality accounting degrees is a worrisome trend. In order to ensure a baseline of quality in tertiary education, other countries (e.g., Argentina, Brazil and Peru) in the region have moved toward a system of program evaluation and an accreditation process. Nonetheless, the significant human capacity needed to operate such evaluation and accreditation system poses a significant challenge given the budget constraints government face in most countries.

50. **The proposed new accounting law (Para. 41-42) would institute a professional certification system, including an examination, in order to ensure that candidates for the accounting license have acquired the necessary knowledge and skills to practice.** This proposal is similar to what has been implemented in Mexico, with the *Contador Público Certificado* (CPC) credential. The relatively demanding Mexican credential allows its holder to practice accountancy in the United States and Canada, after passing a short exam on national standards and tax legislation.⁴⁴ The creation and

⁴³ A new law creating a National Council on Evaluation and Accreditation is currently being debated in the legislature. This body would have the authority to evaluate higher education institutions and close them if they do not meet certain standards of quality to be determined by the new Council.

⁴⁴ Mutual recognition of professional designations is embodied in the Dominican Republic – Central American Free Trade Agreement (DR-CAFTA), of which Nicaragua is a signatory.

successful execution of such a certification system would create demand-side incentives for universities to improve the quality of their accounting education to meet the demands of the exam. It would also provide an objective means to measure the quality of education at different institutions.

51. **There are insufficient opportunities for continuing professional development (CPD) for members of Nicaragua’s accounting profession.** In particular, a common theme heard from Nicaragua’s accounting professionals was the lack of opportunities for high-quality instruction in IFRS. Given the *Colegio’s* goal of transitioning to IFRS by 2011, the need for such instruction is particularly acute. Yet the majority of IFRS training is offered only to staff and clients of the larger, internationally affiliated audit firms. The *Colegio’s* CPD courses are popular yet insufficient to meet the demand or to prepare Nicaragua’s accountants for the coming transition to international standards.

52. **Based on the above, in order for Nicaragua’s decision to adopt IFRS and ISA to translate into tangible improvements, its universities and *Colegio* need to strengthen their educational standards.** Efforts to revamp accounting curricula, to train faculties, or to equip the accounting department within each university with up-to-date learning material, would help achieve that objective. Besides these supply-side interventions, the introduction of a professional certification for licensed accountants—following the example of Mexico’s *Contador Público Certificado*—would provide appropriate incentives for universities to enhance their educational standards and would generate demand for excellence in accounting education at the tertiary level. Such introduction represents a ground-breaking reform, and therefore will require time and significant resources. Given its relatively modest resources, the *Colegio* would probably not be able to design and implement such a system without significant external support. For that reason and also considering the benefits of a better integrated accounting profession and harmonized accounting and audit practices at the regional and sub-regional levels, a regional solution would be most appropriate in that regard.⁴⁵

D. Accounting and Auditing Standard-Setting

D.1 Accounting

53. **Nicaragua has no standard-setting body that is legally empowered to issue binding accounting standards for businesses.** The *Colegio’s* Accounting Standards Committee (CNC) issues or adopts standards that are binding only on the members of the *Colegio*.⁴⁶ Yet these standards cannot be considered national accounting standards because the businesses themselves are not required to follow them. Businesses need not employ members of the *Colegio* as their accountants and, indeed, most do not (as previously mentioned, membership in the *Colegio* is only required to work as an accountant in *public* practice). Moreover, these standards are only nominally binding on

⁴⁵ For a more in-depth discussion of accounting and auditing education reforms in the LAC region, please refer to Accounting for Growth in Latin America and the Caribbean, Chapters 4 and 7.

⁴⁶ Law on the Practice of Public Accounting, Law No. 6 of April 14, 1959, Article 17 and Article No. 43 of the Regulation to the Law on the Practice of Public Accounting.

the *Colegio's* members, as the *Colegio* has never expelled one of its members for failing to adhere to its accounting standards.

54. **Even if the *Colegio's* CNC had the requisite authority to serve as a national accounting standard-setter, it does not have the human and financial resources, nor the institutional capacity, to perform this function.** First, all of the members of the CNC currently serve on a *pro bono* basis—they are appointed annually by the *Colegio's* board of directors—and meet infrequently. The CNC does not have any paid staff members. Second, the annual turnover of the CNC inhibits the standard-setting process. The members of the CNC need time to develop expertise in international standards, plan an adoption and implementation process for new standards, and to encourage their adoption by the country's businesses. Third, the CNC lacks adequate representation from interested parties outside of the profession. In order for a national accounting standard-setter to attain legitimacy with the broader business community, it needs representation from a broad range of stakeholders with an interest in the prevailing national accounting standards—including MHCP, SIBOIF, financial-sector companies, the wider business community, academia, etc. A professional, multidisciplinary national accounting standard-setter could also participate in the drafting of IFRS or IFRS for SMEs (for example, by submitting formal comments to IASB on exposure drafts of new standards).

55. **The CNC has taken initial steps toward the adoption of IFRS for public interest entities in Nicaragua.** It resolved in 2003 to adopt International Accounting Standards (IAS), the predecessor to IFRS, as Nicaragua's official accounting standard, beginning in 2004. This requirement was postponed, and, in 2009, the CNC decided to extend the deadline until June 30, 2011. The resolution clarified that IFRS will become the national standard only for the regulated, public interest entities that are currently required to follow Nicaraguan GAAP ("PCGA" in Spanish), including listed companies, the handful of borrowers of more than US\$750,000, and SOEs. The resolution said that IFRS for SMEs may be adopted in the future for private entities (that is, non-listed, non-supervised companies) (Para. 57). International experience in Europe, Latin America, and elsewhere has shown that effective IFRS adoption typically requires between 4 and 5 years, and an accompanying program of capacity-building activities and intermediate deadlines to ensure the business community's readiness for the transition to IFRS. Unfortunately, the CNC lacks the resources and the authority to plan and coordinate a nationwide effort to transition to IFRS.

56. **The CNC, recognizing the constraints on its time and resources, adopted a resolution in 2009 to automatically adopt new IFRSs as they are issued by the IASB.** If and when IFRS becomes the national accounting standard in Nicaragua for public interest entities, this change will eliminate a common problem of many national accounting standard-setter—that of adopting a standard that quickly becomes obsolete upon the passage of more up-to-date standards.

57. **The CNC's next challenge is likely to be in formulating strategy for the successful implementation of IFRS for SMEs.** In 2009, IFRS for SMEs—a simplified version of IFRS for companies without public interest characteristics—was issued by the

IASB. Adopting these new standards could be a means for Nicaraguan companies to enhance significantly the quality of their financial information and to achieve a higher level of international comparability and integration. The CNC issued a resolution publicly praising IFRS for SMEs, but it has not yet officially endorsed them for use in Nicaragua, nor has it proposed a plan for adopting and transitioning to these new standards.

D.2 Auditing

58. **Similar to the case with accounting standards, the *Colegio* has an Audit Standards Committee (CNA) that issues audit standards for the members of the *Colegio*.** CNA's standards are binding on the members of the *Colegio* and therefore on the audit profession as a whole, as auditors must be members of the *Colegio* in order to sign audit opinions. Nonetheless, the CNA also suffers from capacity constraints that limit its effectiveness. Similar to its accounting standards counterpart, the CNA's members work *pro bono*, are appointed annually, and meet infrequently. They also have no paid staff members to assist them with their work.

59. **In 2003, the CNA formally adopted the version of ISA that was in force at the time.** The CNA's current rules require it to issue new resolutions every time ISA undergoes a change, but it has not issued any new resolutions. Consequently, the current audit standard in force is ISA from 2003, which is out of date. The CNA should consider putting in place a standing resolution, similar to CNC's for IFRS, adopting the current version of ISA as issued by the International Audit and Assurance Standards Board and automatically incorporating future changes to the standards.

E. Enforcement of Accounting and Auditing Standards

E.1 Accounting

60. **The *Colegio* does not enforce its members' compliance with Nicaraguan PCGA, and lacks the human and financial resources to enforce compliance with IFRS if that becomes the prevailing national standard in 2011, as scheduled.** Moreover, the *Colegio* does not have the authority to enforce enterprise standards on most companies (those that hire accountants who are not members of the *Colegio*). The *Colegio* has an Honor Council, which has the power to warn, suspend, or revoke the license of a member who violates ethical or professional standards. Such enforcement action is exceedingly rare—the last suspension applied occurred more than ten years ago, and it was reportedly to sanction a former *Colegio* president who had failed to pay his membership dues. Even if the Honor Council were to be used to enforce adherence to enterprise accounting standards, the Honor Council is not set up to perform this task effectively. Its members serve *pro bono* for one-year terms, and most of them lack in-depth knowledge of IFRS—required to review financial statements and detect non-compliance. In fact, the near-universal experience with Honor Councils across the region is that they are not credible enforcement bodies.

61. **SIBOIF’s enforcement capacity in the banking sector is relatively strong, but its staff lacks a strong base of knowledge of IFRS.** SIBOIF carries out *extra situ* reviews and *in situ* inspections of banks and finance companies. It also works with audit firms to identify weaknesses in financial institutions’ internal control systems, and reviews the auditors’ working papers on occasion. SIBOIF’s banks department is moving toward an increasingly risk-based approach to its inspections. Although SIBOIF staff members are aware of A&A issues, they lack in-depth knowledge of IFRS, notwithstanding that SIBOIF rules require such knowledge (to apply IFRS in case of lacunae in the MUC). SIBOIF has held annual training sessions on IFRS for staff; however, training should be expanded to all technical staff in order to create a specialized group of staff members with significant IFRS expertise and comprehensive IFRS training.

62. **SIBOIF has the authority to impose sanctions of up to US\$60,000 with regard to banks’ financial reporting obligations.**⁴⁷ SIBOIF imposes sanctions for violations of banks’ financial reporting requirements with some regularity, and posts these on its website, but the relatively small sanctions at SIBOIF’s disposal may be insufficient to deter violations. Posting the sanctions on SIBOIF’s website is considered good practice, which is relatively uncommon in the region. The publication of the sanctions would be more useful to third parties and might have a greater deterrent effect if fuller details (such as the decision memo accompanying the sanctions) were published along with the fine.

63. **SIBOIF’s enforcement capacity in the insurance sector is adequate given the small number of companies under supervision, although it is weaker than in the banking sector.** SIBOIF’s insurance department⁴⁸ performs *extra situ* and *in situ* inspections of insurers and reinsurers, as well as inspections of internal control systems, utilizing the work of external auditors as a complement to their inspections. SIBOIF’s insurance department has the same sanctioning power as the banks department, and it publishes its sanctions on the SIBOIF website. At the same time, it was noted that not all insurance companies are in compliance with SIBOIF’s requirement that they post their complete audited financial statements on their websites.⁴⁹ This may be indicative of a relatively more relaxed enforcement posture in the insurance sector than in the banking sector. A new Insurance Law, under consideration in the National Assembly, would open the insurance sector to foreign companies, which would likely require more resources for SIBOIF’s insurance department in order to supervise the expected additional companies.

64. **SIBOIF’s enforcement capacity in the securities sector may be insufficient to provide the necessary reassurance to potential investors.** Two inspector-analysts are responsible for ensuring that companies associated with the stock exchange comply with

⁴⁷ SIBOIF standard on Imposing Sanctions, Resolution No. CD-SIBOIF-410-1-MAR14-2006 of March 14, 2006.

⁴⁸ SIBOIF’s Department of Insurance comprises staff with different areas of expertise, and includes three actuaries, three accountants, one economist, and two lawyers, although the team is smaller and possibly less experienced than the banks’ department.

⁴⁹ For example, one insurance company published its financial statements without notes, which significantly reduces their usefulness.

SIBOIF's prudential and corporate governance requirements. SIBOIF's securities department has regularly applied sanctions (which are posted on SIBOIF's website) for failure to comply with A&A requirements. It has also cancelled the registration of one issuer for having its financial statements audited by a firm that was not included in SIBOIF's auditor registry. All three listed companies comply with SIBOIF's requirement that they post their complete audited financial statements on their websites.

65. **Regarding bonded warehouses, considering the small size of this sector, SIBOIF's enforcement capacity is much less of a concern.** Closer supervision of bonded warehouses was implemented after a well-publicized scandal in 2000, involving bonds issued on the basis of fraudulent collateral. SIBOIF's inspectors review financial reports for the four supervised bonded warehouses and also perform in-person inspections of bonded warehouses to assure the quality of the collateral.

66. **SIBOIF's all-in-one structure facilitates regulatory cooperation across sectors and probably strengthens enforcement.** SIBOIF also conserves its resources through a single auditor registry, a unified accounting standards committee, a single website, etc. This coordination and synergy among regulators is unusual in the region and should be considered a good practice.

67. **The CGRN still needs to develop its capacity and appropriate procedures to be able to enforce accounting or auditing requirements in SOEs effectively.** The CGRN performs investigations into specific complaints or allegations, only, and has not adopted a risk-based approach to supervision. Some SOEs operate for years without a financial statement audit by the CGRN or anyone else. The law also does not differentiate between SOEs and other government departments (e.g., ministries) in terms of accounting or auditing requirements. When CGRN does carry out a special audit, its focus is primarily on identifying misuse of funds, rather than on transparent and accountable management of government enterprises.

68. **No ownership structure for SOEs has been set up within the MHCP or the Executive branch in general.** A clearly defined ownership function helps to ensure that the governance of state-owned enterprises is carried out in a transparent manner and that those entities' managers and directors are appropriately accountable for their actions, with the necessary degree of professionalism and effectiveness of their actions. Such structure is more and more commonplace in countries with large state-owned commercial sectors.⁵⁰ If it were established in Nicaragua, it could play a useful role in exercising financial oversight over SOEs.

E.2 Auditing

69. **The oversight of auditors in the financial sector needs strengthening.** As described in Para. 24, the Standard on External Audit requires regulated entities in all sectors (banks, insurance companies, listed companies, and bonded warehouses) to select

⁵⁰ Examples include Brazil, France, South Africa, Sweden, the United Kingdom, and, more recently, Chile.

their external audit firms from SIBOIF's auditor registry.⁵¹ However, the rule does not exclude an audit firm from the registry for lack of experience auditing financial institutions. Rather, the law requires supervised financial institutions to select an external auditor that: (a) is included in SIBOIF's auditor registry, and (b) has "sufficient experience, infrastructure, human and technical capital, and adequate qualifications for the volume and complexity of operations that the audited financial institution undergoes." Rather than making supervised institutions responsible for evaluating the external auditor's qualifications, SIBOIF should include the experience requirement among those for inclusion in the auditor registry. Indeed, not all of the firms on SIBOIF's registry appear to have the capacity to audit Nicaragua's most complex financial institutions. All audit firms should be required to demonstrate adherence to international standards, sufficient professional experience, independence, a sound quality assurance system, a system of continuing professional development for management and staff, and sector-specific knowledge.

70. **The CGRN does not currently exercise strong oversight over SOE external auditors.** The CGRN does keep an external auditor registry, which includes more than 60 audit firms. This large number of firms indicates a lack of "fit and proper" requirements to be included on the registry. In any event, the requirements to be included on the registry are not clearly spelled out in any regulation. SOEs are complex and typically large entities, so audit firms need to have sufficiently qualified personnel in order to carry out a rigorous audit.

71. **As previously noted, the *Colegio* does not monitor the quality of practice among its membership, and there are no requirements for internal firm-level quality assurance processes to ensure that accounting and audit firms are meeting acceptable standards of quality.** The *Colegio*, while mandating ISA for its members, does not have any mechanism to investigate or enforce compliance with ISA or any audit standard. Various stakeholders—including regulators, lenders, investors and other users—rely on the assurance of a clean audit opinion (or the questions raised by the lack thereof) in order to make decisions.⁵² The absence of enforcement mechanisms for sound auditing standards calls into question the reliability of these audits and, by extension, the usefulness of audited financial statements.

⁵¹ Chapter II of Resolution No. CD-SIBOIF-583-2-ABR29-2009 of April 29, 2009.

⁵² For example, a recent report from the Basel Committee on Banking Supervision noted, "The need for bank supervisors to be confident of audit quality remains one of the keys to effective banking supervision..." Basel Committee on Banking Supervision, *External audit quality and banking supervision*, Bank for International Settlements, Basel, Switzerland: December 2008, p. 7.

III. Accounting Standards as Designed and as Practiced

A. Accounting Standards as Designed

72. **As discussed in Para. 16, there is no legally binding accounting standard for enterprises in Nicaragua. The *Colegio* has endorsed Nicaraguan PCGA, which are based on US GAAP and Mexican GAAP, and were last updated in the 1980s. The *Colegio* has set a 2011 as a target date for large companies to transition to IFRS, but there is no process for achieving this goal. The best way to overcome the current ambiguity and difficulty would be for the law to set out a general endorsement of IFRS in Nicaragua and to require a legally empowered standard-setter (i.e., not the *Colegio*) to review and endorse any subsequent changes to IFRS.**

73. **A high-level review of Nicaraguan PCGA showed that these do not represent a complete accounting model and are not consistent with IFRS.** This also leads to a great variation in the quality of financial statements prepared using these standards. Nicaraguan GAAP focus on the measurement of transactions and the presentation of the financial statements, not so much on disclosures in the notes to the financial statements (which are fundamental for a proper understanding of these statements). Specific inconsistencies with IFRS relate to business combinations (Nicaraguan GAAP, Statement 2), allow the “pooling of interest” method whereas IFRS only accept the pooling method; impairment of property, plant and equipment (PP&E) is recognized over the remaining useful life of the assets under Statement 2, instead of the moment when impairment is identified; extraordinary items are still considered under Statement 4 whereas these have been eliminated under IFRS; no cash-flow statement is required under Statement 5 where this is covered under a specific standard (IAS 7) under IFRS; Statement 11 does not require normal production to be used to allocate indirect production costs to inventories contrary to IAS 2; goodwill is amortized over a ten-year period under Statement 14 instead of subject to annual impairment tests under IFRS 3; etc.

74. **Regarding banks’ financial reporting, a number of differences exist between SIBOIF rules and IFRS.** SIBOIF’s prudential requirements supersede and supplant IFRS (or USGAAP requirements) where they conflict. In 2007, SIBOIF issued a new Unified Accounting Manual (MUC) for banks (as well as all other supervised institutions). The accompanying instructions stipulate that, where the MUC is silent, supervised entities should follow IFRS, or USGAAP in case the issue is not covered under IFRS.⁵³ The primary differences relate to four main areas:

- (a) ***Determination of loan provisions.*** Under the MUC, provisions for losses are evaluated using a “matrix-based” approach, i.e., one that requires fixed percentages of provisions to be applied to the principal amount depending on the

⁵³ SIBOIF standard on the Unified Accounting Manual for Banking and Financial Institutions, Resolution No. CD-SIBOIF-468-1-FEBR28-2007, Annex 1 (Unified Accounting Manual), General Instructions, Point 10a.

number of past-due days for different categories of loans. This method is consistent with the approach by most bank supervisors in Latin America for prudential purposes. It differs in its approach with IAS 39, *Financial Instruments: Recognition and Measurement*, which requires assessing loss provisions on the basis of estimated future cash flows by loan or group of loans. It therefore may lead to significantly different values than those that would have been determined under IFRS, although the magnitude of such differences could not be assessed. It should be noted that the local subsidiary of an international banking group specialized in small business and microfinance applies a matrix that is more conservative than SIBOIF's.

- (b) ***Valuation of securities investments*** – SIBOIF requires banks that hold securities to maturity to depreciate their value according to a fixed schedule if the issuer of the security suffers a deterioration in their economic solvency or if there exists a high probability of default; if a scheduled interest or principle payment was missed by more than 90 days; if there is no longer a liquid market for the security; or if a significant deterioration in currency, country or other risk occurs. This conflicts with IFRS (IAS 39), which require these investments to be valued at amortized cost using the effective interest method, less impairment (impairment being recognized during the period).
- (c) ***Valuation of property received as collateral on loans*** – Property given as collateral by debtors and reclaimed from them must be written-off completely after 18 months if it has not been sold, except for property “of social interest,” valued at less than US\$17,500. IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* requires that this type of asset be valued at the lower of carrying amount and fair value less costs to sell.
- (d) ***Quality of disclosures*** – The accompanying notes to financial statements template set out in the MUC, while broadly consistent with IFRS in terms of structure and topics covered, do not provide for the same level of detail and depth of disclosure as IFRS.

75. **The accounting standards currently in force in the insurance sector also differ from IFRS in a number of significant aspects.** The main areas of discrepancy with IFRS in the insurance sector are the following: (a) the valuation of insurance liabilities, and the lack of a liability-adequacy test, which is required by IFRS 4, *Insurance Contracts*; (b) the valuation of financial instruments and the fact that embedded derivatives in insurance contracts are not recognized under prevailing accounting rules; (c) the recognition of deferred taxation, which is required under IFRS but not by SIBOIF; (d) a much lower level of disclosure than under IFRS; and (e) the netting of several types of insurance policy-related assets and liabilities which is permitted under SIBOIF rules. Considering the above discrepancies, the financial statements of insurance undertakings would most likely portray their financial position much differently if they were prepared in accordance with IFRS. **It would be a particularly useful exercise for SIBOIF's insurance department to map the**

differences between SIBOIF's MUC and IFRS, which would facilitate further convergence and eventual IFRS adoption.

76. **Nicaragua is one of the few countries in Latin America and the Caribbean that does not require—although it does allow—companies listed on its stock exchange to apply IFRS (some countries also allow USGAAP).** Companies that issue securities on Nicaragua's exchange or whose securities are traded on the secondary market must follow "Generally Accepted Accounting Principles in Nicaragua [“PCGA”], IFRS and, in the absence of these, US GAAP. If the PCGA, IFRS and US GAAP accept varying alternatives, companies should opt for the most conservative approach”⁵⁴ This requirement is ambiguous, as companies are not required to disclose what accounting treatment is applied to different parts of their financial statements (e.g., if a specific asset was valued using PCGA, IFRS or US GAAP). Financial institutions on the securities market must follow the SIBOIF's MUC for financial companies. These accounting standards, similar to those issued for banks and insurance companies, are prudential in nature and conflict with IFRS.

B. Observed Reporting Practices

77. **The review of a sample of 16 sets of 2008 financial statements of relatively large Nicaraguan corporate entities found that, while appearing of reasonably good quality, these financial statements fall short of the standard of IFRS in several important aspects.**⁵⁵ Since closely-held companies (including unregulated microfinance entities) are not required to publish their financial statements, the review sample was limited to PIEs. Consequently, the review does not provide per se a sufficient basis for evaluating actual corporate financial reporting practices in Nicaragua, even though they do provide relevant anecdotal evidence in that regard.

78. **The review identified incomplete or inadequate application of IFRS in the follow instances:**

- An entity had revaluated part of its PP&E, whereas IAS 16 requires, in case a company elects to revalue PP&E, that it does so for the entire class of assets. Also, revaluations have been performed once, while IAS 16 requires that when a revaluation has been made, periodic assessments be conducted;
- Most entities had not recorded any deferred taxes as required by IAS 12, including in the above-mentioned case where a revaluation was recognized. This means that the financial position of these entities may be over- or under-stated;

⁵⁴ Art. 9 of SIBOIF standard on Corporate Governance for Issuers of Publicly Traded Securities, Resolution CD-SIBOIF-559-2-NOV5-2008 of November 5, 2008.

⁵⁵ All the financial statements were prepared as of December 31, 2008. All 16 entities reviewed are public-interest entities. These include three banks, two insurance undertakings, three bonded warehouses, one factoring company, and seven enterprises, two of which listed on the local stock exchange, and two of which state owned.

- No enterprise applied fair value measurements to their financial assets and liabilities, although such measurement is required by IFRS in a number of circumstances. Moreover, one bank did not measure a bond's value at fair value upon its initial recognition even though this is explicitly required by IAS 39, thereby significantly overstating its financial position;
- Both state-owned enterprises recognized grants received from international financial institutions and other entities directly through equity, and not as income. Even though IFRS do not prescribe any specific treatment for such grants, since the donors in this case do not hold any interest on the entities' net assets, these are by nature an element of income;
- For all entities, including those applying IFRS in full, the presentation of accounting policies in the notes was at times confusing and incomplete, shedding some doubt as to whether they did indeed comply. Moreover, disclosures of accounting policies often describe the transactions rather than the accounting policy followed;
- In the area of disclosures in the notes to the financial statements, other departures were identified relating to: a) securities investments and financial liabilities, for which rates of return and maturity dates were omitted; also, no financial instruments assets classification is used, mostly shown as investments in general; b) the reconciliation between information included in the statement of cash flows with other included in other notes; c) for PP&E, the reconciliation of beginning and ending balances was often absent, especially for accumulated depreciation; d) related-party transactions; e) contingencies and commitments (no information on at all was presented in several cases); f) risk exposures and risk management policies; g) groups of transactions were shown as "others"; h) earnings-per-share and segment information in the case of two listed companies. Overall, the quality of the disclosure in the financial statements was not up to the standard of IFRS.
- The review confirmed (see Para. 74-75) that accounting measurements in the banking and insurance sectors are often dictated by prudential considerations that are different from, or conflict with, IFRS.

79. **The review further confirmed that multiple accounting systems are used in Nicaragua, contributing to a general lack of clarity.** Financial institutions prepared their financial statements based on SIBOIF regulations; four of the enterprises financial statements included a statement to the effect that they comply with IFRS; one prepared its financials under financial accounting standards generally accepted in Nicaragua, and the other three prepared their financials under generally accepted accounting principles in Nicaragua.

80. **The review also confirmed that current accounting policies for state-owned enterprises are largely insufficient for a fair and complete presentation of their financial condition and performance.**

IV. Auditing Standards as Designed and as Practiced

81. **ISA has been adopted by the *Colegio* for all financial statement audits.** SIBOIF-regulated companies are subject to an annual statutory audit and companies that borrow more than \$750,000 are also subject to a mandatory external audit (Para. 17). SOEs are subject to audit by CGRN under NAGUN, and may choose to be audited by an external audit firm. External audit firms typically audit SOEs using “ISA and NAGUN.”

82. **Adherence to ISA by Nicaragua audit firms, especially small and medium practices, is hampered by weak oversight of the statutory audit function.** A meeting was held with representatives of the largest audit firms in Nicaragua to discuss auditing practices, among other issues relevant to this ROSC. Several issues were raised during the discussion pointing to the need to improve current practice. For instance, they pointed out that, although the law requires companies that borrow between \$300,000 and \$750,000 to obtain a “certification” of their financial statements, this term has not been defined. The *Colegio* is currently working with SIBOIF to determine a definition. Audit firms also highlighted the practice among SIBOIF-regulated entities and SOEs of signing one-year contracts, and of annual changes in audit firms, particularly among SOEs. This frequent change of auditors is unusual (the law requires rotation only every three years) and prevents audit firms from gaining a deep knowledge of the company under audit. It probably diminishes the quality and value of the audits as well. Participants also pointed to the need to significantly improve accounting education to ensure that audit practitioners are adequately prepared. For instance, several participants mentioned that some smaller firms do not apply ISA, and there is a lack of quality assurance to ensure compliance with ISA and the *Colegio*’s Code of Ethics.

V. Perceptions on the Quality of Corporate Financial Reporting

83. **The demand for high-quality corporate financial reporting in Nicaragua is relatively weak, although the new requirement for banks to obtain financial statements from borrowers before extending credit may strengthen the demand.** The requirement for the financial statements to be audited will be limited to a relatively small subset of large (>\$750,000) borrowers, but this is a step in the right direction of imposing higher requirements on larger, public interest entities. Several banks expressed concern that some of Nicaragua’s larger agricultural companies and individual borrowers would have difficulty complying with the requirement.

84. **Lenders expressed a reasonable level of confidence in the financial statements of large borrowers.** Lenders also reported that SMEs (when they have audited financial statements) are typically audited by individuals or small firms, and that these financial statements might be less reliable. Some banks reported asking respected members of the *Colegio* to vouch for their colleagues in order to ascertain whether a particular company’s certified or audited financial statements were reliable.

85. **Perceptions of the accounting and auditing profession within the business community are mixed.** Based on panel discussions and interviews with lending institutions, business executives and regulators, there are doubts about the ability of Nicaragua’s accountants to apply IFRS, especially those working in small firms or sole proprietorships. Nonetheless, the *Colegio* enjoys a good reputation as an institution among many professionals. Several felt that the accountant qualification needed to be strengthened through a mandatory accounting examination or other measures. Others felt that the accounting profession was not particularly relevant to Nicaragua’s business climate. For example, one interviewee felt that there was no overall perception of accountants or auditors in Nicaragua because so few businesses use their services.

86. **With respect to auditing, few auditing firms are deemed reliable, outside of the “Big 4”.** Indeed, until recently, SIBOIF restricted membership in its auditor registry to foreign-affiliated firms, demonstrating a lack of confidence in the local firms. Companies frequently incur delays in issuing audited financial statements after the close of their fiscal year because the larger, more reputable audit firms do not have enough staff to keep up with the demand for their services.

VI. Recommendations

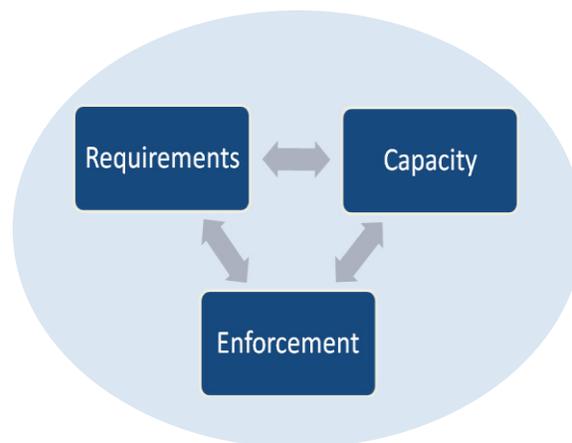
87. **Based on the above, accounting and auditing practice in Nicaragua are still at an early stage of development, and very significant efforts will be necessary to bring them to par with international standards.** Sustainable improvements and successful reforms require a holistic approach, addressing all key aspects of a strong A&A framework, from sound laws to adequate education systems and robust enforcement.

88. **It is recommended that detailed recommendations be finalized in consultation with the Nicaraguan authorities and in-country stakeholders during a workshop in Managua.** Instead of including prescriptive recommendations in the draft ROSC report, the approach used in this case is to incorporate as many inputs as possible from the national authorities and the local private sector and herein only suggest a framework for solving the identified issues.

89. **Strong corporate financial reporting systems are built on three pillars:**

- Setting adequate requirements;
- Developing capacity to implement applicable rules; and
- Enforcing applicable standards effectively.

Adequate requirements are clear, comprehensive, consistent, fair, and up-to-date laws and regulations, as well as rigorous standards for A&A. Capacity to apply appropriate standards requires skilled accountants, robust accounting education, and a system to maintain and upgrade skills on a continuing basis. A rigorous enforcement regime ensures compliance with the standards. These three pillars reinforce each other: setting requirements at the appropriate level makes enforcement easier and avoids unnecessarily stretching companies' capacity to comply.



The Three Dimensions of Financial Reporting Systems

90. **To build consensus and momentum for reform, Nicaragua's authorities may wish to pursue a number of relatively simple, short-term policy changes ("quick wins") whose benefits will be felt immediately.** Some of these suggested quick wins are:

- a) The *Colegio* should proceed to adopt IFRS for SMEs and decide on a definition of SMEs for financial reporting purposes. This definition should be determined in consensus with SIBOIF and other relevant national authorities and it should be determined after reviewing the work of other Central American standard-setters in this area.

- b) The *Colegio* should review and disseminate the Spanish translation of IFAC’s *Guide to Using International Standards on Auditing in Small- and Medium-sized Entities*, given that the preponderance of Nicaragua’s businesses are SMEs.⁵⁶
- c) The *Colegio* should strengthen its outreach to the major universities that offer an accounting degree, with a view toward establishing a curriculum upgrade and an ongoing review process in cooperation with university accounting departments.
- d) SIBOIF’s Standards Department should prepare and publish (with the help of outside experts if required) a map of the differences between SIBOIF’s MUCs and IFRS.

91. **In the medium-to-long term, country authorities may wish to tackle a set of more challenging—but nonetheless important—reforms.** The most urgent of these reforms are:

- a) SIBOIF should implement an IFRS training program (perhaps in cooperation with counterparts from other Central American countries) for certain members of its staff, following the recent experience of Honduras’s National Banking and Insurance Commission (CNBS). Specifically, SIBOIF needs a group of staff members with significant IFRS expertise and comprehensive IFRS training among all technical staff.
- b) GoN should take steps to align its management of SOEs with the principles outlined in OECD’s *Guidelines on Corporate Governance of State-Owned Enterprises*. Among the most important of these are (i) establishing a clear “ownership function” and (ii) shifting SOE financial reporting and audit requirements toward private-sector standards. CGRN should also seek to alleviate the bottleneck that leads to some SOE audited financial statements being unavailable to the public several years after they have been prepared.
- c) The *Colegio* and other country authorities should lay the groundwork for a national audit quality assurance regime to safeguard the interests of users of audited financial statements. When considering the various alternatives, country authorities and representatives of the profession should review the experiences of El Salvador’s Accounting and Auditing Oversight Board (CVPCPA) and Honduras’s Accounting and Auditing Standards Technical Board (JTNCA).
- d) Given the importance of its microfinance sector, Nicaragua should introduce a two-tier regulatory system for microfinance institutions (including cooperatives) where the largest institutions are prudentially regulated by SIBOIF, and the smaller institutions are subject to a simplified financial reporting and audit regime.

⁵⁶ A Spanish-language translation (*Auditoría Financiera de PYMES: Guía para usar los estándares internacionales de auditoría en las PYMES*) is available on IFAC’s website, at <http://www.ifac.org/Translations/database.php>.

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

- a) ***Simplifying accounting and auditing obligations whenever appropriate***, especially for SMEs, to reduce the cost of doing business in Nicaragua for modest-sized businesses. Accounting/audit obligations should be reasonably justified in terms of public policy objectives;
- b) ***Strengthening existing mechanisms*** to the extent that they are conceptually sound and sustainable, rather than seeking a complete overhaul of existing mechanisms;
- c) ***Consolidating the institutional framework*** in order to (i) eliminate duplication of efforts, (ii) avoid multiple requirements that may be contradictory and cause confusion and (iii) foster synergy between regulatory agencies for maximum and best results;
- d) ***Implementing international standards, including the IFRS for SMEs***, as opposed to developing custom-made solutions that are costly and difficult to maintain, and which do not convey the same level of confidence as international ones. Custom-made solutions can represent an added cost of doing business for foreign investors and domestic enterprises that are used to conducting business internationally;
- e) ***Building collaborative arrangements and strengthening ties with other Central American countries to develop a common corporate financial reporting framework.***

93. **In order to prioritize and achieve consensus on these and other reform proposals, an IFRS country action plan (CAP) is expected to be developed under the aegis of the authorities and the *Colegio*, possibly with the assistance of the World Bank and other development partners.** The IFRS-CAP should include a time-bound series of steps (with their associated costs) with clear lines of responsibility for their accomplishment. The IFRS-CAP will provide a detailed roadmap for reform and capacity development initiatives benefiting the Nicaraguan accounting profession, businesses and regulatory agencies, based on the ROSC's assessment of current conditions and agreed-upon policy recommendations.