The Adoption of International Financial Reporting Standards: The Case of Rwanda

Lesley Stainbank
Théobard Ntukabumwe

Abstract

This study reports the results of a questionnaire survey which ascertained the opinions of the preparers of financial statements in Rwanda on the usefulness of financial reporting and non-financial reporting; on how the respondents thought Rwandan financial and non-financial reporting could be improved; and what steps Rwanda could take to improve the situation. This is an exploratory study that makes use of a questionnaire survey to collect data on the perspectives of the preparers of financial statements in Rwanda. Although a small majority of the respondents were of the opinion that their company's annual report was useful to users, a question probing the composition of the annual reports showed some shortcomings in the annual reports. They were also of the opinion that a sustainability report should form part of narrative reporting, and that current narrative reporting is not suitable in Rwanda. Respondents recognised the need to improve corporate reporting in Rwanda and felt that this could be achieved mainly by regulating the accounting profession and by adopting the International Financial Reporting Standards.

Keywords: developing countries, Rwanda, International Financial Reporting Standards, foreign investment, financial reporting

Introduction

While research has traditionally focussed on the analysis of developed countries' financial reporting, there remains a deficit in the literature regarding some developing countries. Rwanda is one such country. This research partially addresses this problem by focusing specifically on financial reporting in Rwanda.

Rwanda is a central African country that was a former colony of Belgium. It gained independence in 1919, and its first democratic elections were held in 1961. In 1994 the country experienced one of the most harrowing genocides of modern history, from which it is still trying to recover. The economy of Rwanda was decimated as former government officials fled the country and took virtually all the financial capital with them. The economic ramifications of the genocide were severe with Gross Domestic Product (GDP) contracting by 10% in 1993 and 49% in 1994 (United Nations Economic Commission for Africa (UNECA) 2010). The country struggled for the remainder of the 1990's, but since 2001 has been one of the fastest growing economies in Africa, although this was from a low starting point. One of the explicit policy objectives of the post-genocide government is to increase economic development through the promotion of foreign investment in Rwandan companies.

It is recognised that a prerequisite for international investment is financial transparency and a well-functioning capital market (Hegarty, Gielen & Barros 2004). Annual reporting and the international comparability of these annual reports is an important element of financial transparency and disclosure. To this end, Standard and Poors (2002:6) note that 'a focus on annual reports facilitates the analysis and comparison of companies around the globe. Academic researchers have identified annual reports as the principal communication device available to companies'. Consequently, this paper discusses the status of financial reporting in Rwanda as a communication device for transparency and disclosure in attracting investment in Rwanda.

The World Bank (2008:10) found that accounting practices in Rwanda differ from institution to institution and are different to the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) (IASB 2011). These accounting practices are not as comprehensive as IFRS and subsequently provide little international comparability. The Rwandan Stock Exchange commenced operations in 2008 (World Bank 2008:6) and the Institute of Certified Public Accountants of Rwanda (ICPAR) was set up in 2008

(ICPAR 2012). As both of these institutions are in their infancy, they do not yet provide strong guidance regarding financial reporting.

Problem Statement and Research Questions

In Rwanda, companies use a variety of financial reporting frameworks to provide financial information (World Bank 2008). Furthermore, to date, no peer-reviewed research, as far as the researcher is aware, has been conducted regarding financial reporting in Rwanda and only a limited number of annual reports are available in the public domain in Rwanda. This paper aims to address this gap in the literature by providing information on Rwandan companies' financial and non-financial reporting.

This exploratory study provides only descriptive statistics and probes the areas of financial reporting and narrative reporting in Rwanda by asking:

1. What are the perspectives of the preparers towards the usefulness of the financial statements and the extent of the financial statements' conformity to IFRSs?; and

2. What are the perspectives of the preparers towards the suitability of narrative reporting for Rwanda and how could narrative reporting be improved in Rwanda?

In addition, a limited review of financial reports in Rwanda was also carried out. The study next discusses the literature review, followed by the research methodology and the research findings. Finally the conclusions, limitations of the research and areas for further research are discussed.

Literature Review

According to Wong (2004), a 'financial reporting system supported by strong governance, high quality standards and sound regulatory frameworks is key to economic development'. Pacter of the IASB comments that a spin off from producing accounting standards is economic development and better capital markets (Bruce 2011). This underlies the role of financial information in capital markets that is to enable the optimal allocation of savings to investment opportunities. Entities provide information through their corporate reports that are produced in accordance with the accounting rules and/or principles of individual countries. Accounting may therefore play a role in the economic development of countries.

The G20 insists that the improvement of financial reporting within developing economies is an important part of the remit of the IASB (Bruce 2011). Most of the African capital markets can be classified as emerging market economies which are defined as those economies in which the capital markets have developed 'to the point of contributing to the national financial pool and are usually able to receive some external portfolio investment' (Salter 1998:211). Recent reports from the International Monetary Fund (IMF) and the United Nation's Agency for the Built Environment indicate that sub-Saharan regional GDP is expected to grow by 5% in 2011 and that the region's resilience owes much to sound economic policies with 'steady growth, low inflation, sustainable fiscal balances, rising foreign exchange reserves and declining government debt' (Bruce 2011).

In 2005, of the 48 African countries listed on the IASPLUS website, only six countries required IFRS for all domestic listed companies, nine countries did not permit IFRS for domestic listed companies, six countries permitted IFRS for domestic listed companies, and one country permitted listed companies other than banks and financial institutions to use either IFRS or the national Generally Accepted Accounting Practice (GAAP). For 26 countries there was no information available (Deloitte 2005). In 2010, 11 countries require IFRS for all domestic listed companies, nine countries do not permit IFRS for domestic listed companies, four countries permit IFRS, four countries do not have stock exchanges and while one does not permit IFRS, three require or allow IFRS, one country requires IFRS from 2012 and one country allows listed companies to choose between IFRS and domestic GAAP. For 17 African countries there is no information available (Deloitte 2010). It would therefore seem that the adoption of IFRS by African countries is still in the early stages.

The World Bank and IMF joint Report on the Observance of Standards and Codes (ROSC) initiative covers a set of 12 internationally recognised core standards and codes relevant to market stability and private and financial sector development. This provides further information with regard to the standards relating to accounting and auditing. According to the

World Bank, 'global financial stability rests on robust national systems and … requires enhanced measures at the country level' (World Bank 2004:1). Internationally, 'standards enhance transparency' and nationally, 'standards provide benchmarks' (World Bank 2004:1). One of the objectives of their reviews is to assess the comparability of national accounting and auditing standards with IFRS and International Standards on Auditing (ISA), and to assess the degree to which corporate entities comply with established accounting and auditing standards in the county. Currently, information on five African countries is available on the World Bank website. The World Bank's (2008) ROSC on Rwanda indicates that a strong financial reporting regime for corporate entities in both the public and private sectors will benefit the Rwanda economy by:

- Contributing to financial sector development by strengthening the country's financial architecture;
- Broadening the financial system through strengthening microfinance institutions which will empower local communities;
- Increasing Foreign Direct Investment (FDI) by improving the confidence and comparability of financial information;
- Facilitating economic integration internationally by aligning national standards and codes to those of it main trading partners; and
- Improving access to financing for the Small and Medium-sized Enterprise (SME) sector by providing banks and other financial institutions with standardized useful and reliable information (World Bank 2008:5).

The ROSC (World Bank 2008:9) found that in Rwanda only banking and financial institutions seem to have an IFRS reporting framework and that no effective mechanism exists in the draft Companies Act (subsequently issued by the Office of the Registrar General as Law No. 07/2009 of 27/04/2009 relating to companies) to enforce requirements for accounting and financial reporting. In addition, the lack of implementation guidance constrains the full compliance with accounting and auditing standards. The ROSC team reviewed forty-one (41) financial statements. Accounting practices identified by the ROSC team in Rwanda are shown in Table 1.

Table 1: Accounting practices in Rwanda - 2008

Accounting practices	Total	Audited	Non-audited
Did not apply any principle or standards	19	8	11
Applied local legislation that was not defined	1	-	1
Applied local legislation applicable in Rwanda (not defined)	8	8	-
Applied banking laws and regulation	1	-	1
Applied banking laws and Companies Act	1	1	-
Applied generally accepted accounting principles (not defined)	4	3	1
Applied IFRS	7	6	1
Totals	41	26	15
Source: World Bank 2008			

The ROSC team also found that the quality of the audited financial statements was of concern to the users and that improving quality requires a robust regulatory regime and effective enforcement mechanisms. The ROSC report did not specifically focus on the issue of non-financial or narrative reporting.

The development of financial reporting has been linked or described either by reference to external factors or cultural differences (Gray 1988; Nobes 2004). Gray (1988) explored the influence of cultural factors (using the cultural values identified by Hofstede) on international differences in accounting, Nobes (1998a) listed 17 reasons previously proposed by literature for international accounting differences (1998a:163) but proposed only two explanatory factors: for culturally self-sufficient countries, the dominant accounting system depends on the strength of the equity-outsider market, and for culturally dominated countries, the class of the accounting system is determined by the cultural influence (1998a: 183,184). Nobes (1998b:33) commented that 'there is strong evidence that accounting in developing countries tend to follow colonial or cultural influence rather than fitness for purpose or context'. This may explain Rwanda's adoption of the OCAM (1999) plan that formed the basis of the Rwandan reporting system.

With regard to studies that explain why a developing country would adopt IFRS, Jaggi and Low (2000), in their study on the impact of legal systems on financial disclosures, found that firms in common law countries are more likely to have higher financial disclosures when compared to firms from code law countries. Cultural values have an insignificant effect on financial disclosures by firms from common law countries, with the results from code law countries providing mixed signals. Ding, Jeanjean and Stolowy (2005) in their sample of 52 countries find that culture matters more than legal origin (common law v. civil law) in explaining divergences from IFRS. Zeghal and Mhedhbi (2006:4), applying logistic regression to a sample of 64 developing countries, identified that developing countries with the highest literacy rates, with an Anglo-American culture and capital market are most likely to adopt IFRS. Ramanna and Sletten (2009) find that in a sample of 102 non-European Union countries, more powerful countries are less likely to adopt IFRS, that the likelihood of IFRS adoption first increases and then decreases in the quality of countries' domestic governance institutions and that there was no evidence that levels of and expected changes in foreign trade and investments flows in a country affect its adoption. Judge, Li and Pinsker's (2010), using a sample of 132 countries, find that foreign aid, import penetration and educational attainment, as three forms of isomorphic pressures, are predictive of IFRS adoption.

With regard to specific country studies, Tyrrall, Woodward and Rakhimbekova (2007) examine the relevance and implementation of IFRS to Kazakhstan, an emerging economy; Mashayekhi and Mashayekh (2008) examine the development of accounting in Iran; Joshi, Bremser and Al-Ajmi (2008) examine the perceptions of accounting professionals in the adoption and implementation of a single set of global accounting standards in Bahrain:, and closer to Rwanda, Chamisa (2000) provides a critique of the relevance of IFRS for developing countries, and in particular for Zimbabwe. Finally, a study that attempts to identify the main problems facing an in-transition country, was undertaken in Bosnia and Hersegovina by Malinovic, Bašić, and Alagic in 2007.

All the above studies provide developing countries with some guidance in their own quest to adopt IFRS. The implications of the above studies for Rwanda indicate that the development of financial reporting could be explained in terms of a number of variables and that presenting information on Rwandan corporate reporting would add to the literature on corporate reporting in developing countries.

Research Methodology

Sampling and Data Collection

Since the aim of the research was to ascertain the perceptions of Rwandan corporate companies towards the usefulness of the financial statements and the extent of the financial statements' conformity to IFRS and the suitability for and improvement of narrative reporting in Rwanda, it was necessary to create a list of eligible companies. Firstly, a complete list of Rwandan companies was compiled using data from the Private Sector Federation (PSF) (PSF 2008) of Rwanda, the Rwanda Revenue Authority (RRA) (RRA 2008) and the Rwanda Investment and Export Promotion Agency (RIEPA) (RIEPA 2008). According to the RRA, the 286 companies registered in 2008 were either self-owned (83%), entirely state owned (4%), not entirely for profit (5%) or private corporate companies (9%). The vast majority of Rwandan companies (96%) are located in the capital, Kigali City.

For the purposes of this study, a company was deemed eligible for this survey if it met four criteria: 1) ownership was represented by shares, 2) it was purely corporate, 3) it was not self owned, and 4) it was not entirely owned by the state. Of all the different groups of companies in Rwanda, this sub-population of companies is most likely to be familiar with international reporting requirements and therefore be most suited to comment on these requirements. In Rwanda, all corporate companies end with the suffix SA (meaning *Societe Anonyme*) which indicates that ownership is held in shares. Of the 286 companies registered in 2008, only 26 were corporate companies, i.e. only 26 companies matched the four criteria outlined above. Two of the 26 companies declined to participate in the study which left a sample of 24 companies.

The questionnaire consisted of 28 questions which were either open-ended, categorical or Likert-type questions. The questionnaires were pre-tested on five assistant-lecturers in the Faculty of Management at the Adventist Institute of Kigali (UNILAK) to ensure they were clear and unambiguous. Questionnaires were hand-delivered to each company in the sample and were answered either by the Accounting, Finance, Public Relations or Auditing department. A sub-section of the questionnaire dealt with the particulars of the respondent. A summary of those results is included below:

- The questionnaire was completed by the Chief Accountant (63% of companies), the Head of Finance and Administration (8% of companies), a Manager (12%) or some other employee in the firm (17% of companies).

- 50% of respondents held an Honours degree in Accounting, 29% an Honours degree in Management, and 21% an Honours degree in Economics.

- Only 17% of respondents had more than 10 years experience in their current position, 37% had 5-9 years and 46% of respondents had 1 to 4 years experience in their current position.

Research Findings

Descriptive Statistics

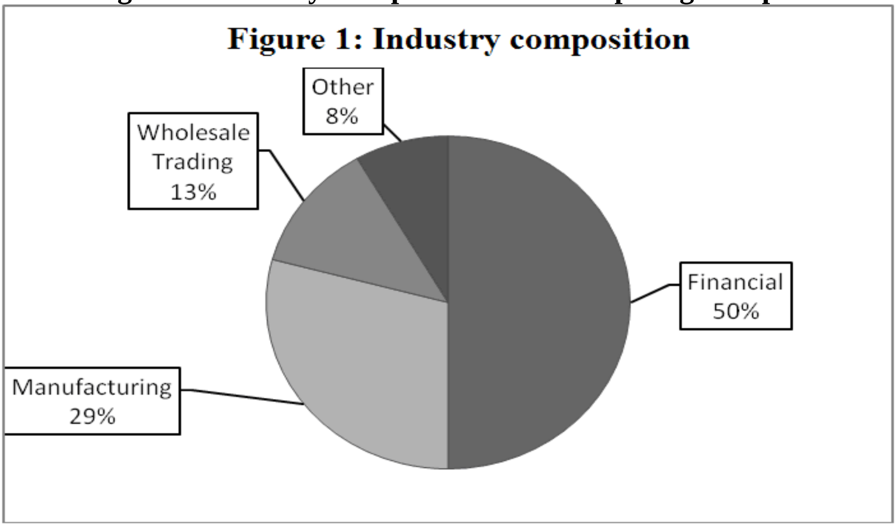
- Using the 1994 Genocide as a reference point, as this is common in Rwanda, 13 of the 24 companies (54%) were incorporated before 1994 while 11 (46%) were incorporated after 1994.
- The head offices of the majority of companies surveyed (92%) were situated in the capital city, Kigali City.
- All but one of the companies in the sample had more than 50 employees while 18 of the 24 companies (75%) had 200 or more employees.
- All companies had turnover of more than RF 150 mil ($250 000) and total assets of more than RF 225 mil ($380 000).
- In 16 of the 24 companies (67%) the Accounting department prepared the annual report. In the remaining companies, either the Finance department (6 companies; 25%) or the Public Relations (PR) department (2 companies; 8%) were responsible for the annual report. In the latter case, it is likely that the PR department prepared the financial statements for issue (and not for audit).

The industry composition of the companies in the survey is shown in Figure 1 below.

Results

All companies in the sample prepared annual reports with 71% of companies using OCAM and 29% using IFRS. It is interesting to note that all 7 companies (making up the 29%) are either banks or insurance companies. This is in line with the ROSC on Rwanda. (The extent of the compliance of the annual reports with IFRS was not pursued in this study.)

Figure 1: Industry Composition of Participating Companies



The RDB's and Kigali Bank's 2005 annual reports indicated that their financial statements are prepared in accordance with Rwandan National Accounting Guidelines in conjunction with conventional practice based on historical cost and as modified by the revaluation of property and equipment. In Rwanda, the main financial statements found in annual reports are namely the balance sheet, the income statement and on rare occasions the cash flow statement (see for instance SONARWA, Kigali Bank and RDB 2005 annual reports). Although these financial statements are found in most annual reports of companies in Rwanda, they are insufficient in content and structure when compared to international standards. Apart from their structural deficiencies, they have significant gaps, such as no statement of changes in equity and omissions in the notes to the financial statements. The balance sheet and the income statement are the two major financial statements in Rwandan accounting practice. However, some companies are beginning to also issue a cash flow statement, which is required by IFRS. This statement is not common in Rwandan companies since it is not required by the OCAM (1999) plan which is the basic foundation of the reporting system in Rwanda. However, some companies for instance, SONARWA's 2005 annual report, RDB's 2005 annual report, and BRALIRWA's 2006 annual report, do disclose this statement.

The questionnaire focused attention on the line items in the balance sheet and the income statement. However, because not all of these annual reports are available in the public domain and to get an idea as to what information companies disclose in their annual reports, respondents were asked what statements are contained in their company's annual report. These results are shown in Table 2.

Table 2: Composition of an Annual Report

Components of an annual report	- Auditor's report - Directors' report - A balance sheet - An income statement - A cash flow statement - A statement of changes in equity -Notes to the Financial statements - Financial highlights - Narrative report	- Auditor's report - Directors' report - A balance sheet - An income statement - A cash flow statement - Notes to the Financial statements - Financial highlights - Narrative report	- Auditor's report - Directors' report - A balance sheet - An income statement - A cash flow statement -Notes to the Financial statements
Companies	4	12	8
Percent	16.6%	50%	33.3%

Table 2 shows that four respondents' (16.66%) annual reports contained the statements in the first column, 12 respondents' (50%) annual reports were composed of the parts in the second column, while 8 respondents' (33.3%) annual reports contained the parts in the third column.

From Table 1 it can be seen that only four companies disclose a statement of changes in equity, and 16 companies include narrative reports and financial highlights in their annual reports. This indicates that companies' annual reports still need some improvements.

In response to a question of how useful the respondents believe their company's annual report is (on a Likert scale of one to five where 1- Not very useful, 2- Not useful, 3- Indifferent, 4- Useful, 5- Very useful), 54% believe that their annual report is useful to users, 42% were neutral and 4% did not answer the question. Considering that, in all probability, respondents are more likely to overstate how useful their annual report is, it is noticeable that 42% of respondents expressed a neutral view – i.e. that their annual reports were neither useful nor not useful.

With regard to narrative reporting, the questionnaire first defined narrative reporting as the contents of the sections usually referred to as the *Management Discussion and Analysis* or the *Operating and Financial Review* and the respondents were asked whether their company included narrative disclosures in its annual report. All the respondents indicated that their company did include narrative reporting in the annual report and their reasons for its disclosure were that it explains more than the basic financial statements (50%), that it is used to provide extra explanations (16.7%), with 33,3% of the respondents not answering this question.

A subsequent question listing a number of disclosure items which could be considered narrative reporting showed that 29% of the companies do not disclose a sustainability report (see Table 3) although all respondents agreed that a sustainability report should form part of narrative reporting.

Table 3: Composition of Narrative Reporting

<table>
<tr><td rowspan="4">Elements of a narrative report</td><td>- Corporate governance report</td><td>- Corporate governance report</td></tr>
<tr><td>- Management discussion and analysis or financial and operating review</td><td>- Management discussion and analysis or financial and operating review</td></tr>
<tr><td>- Directors' report</td><td>- Directors' report</td></tr>
<tr><td>-</td><td>- Sustainability report</td></tr>
<tr><td>Companies</td><td>7</td><td>17</td></tr>
<tr><td>Percent</td><td>29.1</td><td>70.8</td></tr>
</table>

When asked on a Likert scale of one to five (where 1- Very unsuitable, 2- Unsuitable, 3- Indifferent, 4- Suitable, 5- Very suitable), how suitable narrative reporting is in Rwandan companies 71% of respondents believed it is ‘Unsuitable, 17% were ‘Indifferent’ and 13% did not answer the question. Reasons for why the respondents believe narrative reporting is unsuitable in Rwanda could be followed up in future research.

When asked on a Likert scale of one to five (where 1- Totally different, 2- Not similar, 3- Do not know, 4- Similar, 5- Identical) how similar Rwandan corporate reporting and IFRS are, 88% of companies surveyed believe that Rwandan corporate reporting is ‘Not Similar’, 4% believe it is ‘Totally different’ and 8% responded ‘Do not know’.

The questionnaire ended with four open-ended questions. The first question asked respondents if they believed Rwanda should adopt IFRS. All respondents answered ‘yes’.

The respondents were also asked if it was necessary to improve the quality of corporate reporting in Rwanda, and if so why. These results are shown in Table 4.

Table 4 shows that 21% of respondents believe improvement is necessary to comply with international requirements, 17% think it is necessary because there is little accounting regulation, and 8% believe that improved corporate reporting will attract investors. Fifty-four percent (54%) of the respondents did not answer this question.

Table 4: Why Corporate Reporting Needs to be Improved in Rwanda

	%
To comply with international requirements	21
Because currently there is little accounting regulation	17
To attract investors	8
Did not answer	54
	100

The third question asked respondents *how* financial reporting can be improved. These results are shown in Table 5.

Table 5 shows that 38% of the respondents think regulation in the accounting profession could improve the quality of corporate reporting in

Rwanda followed by reforms in accounting (12%) and lastly, training (8%). Forty-two percent (42%) of the respondents did not provide any suggestions. Those respondents who answered this question are mostly in favour of regulation as a tool for improving financial reporting in Rwanda.

Table 5: How can Financial Reporting be Improved in Rwanda?

	%
By regulating the accounting profession	38
By reform in accounting	12
By training	8
Did not answer	42
	100

The final question asked respondents how they believe the quality of narrative reporting can be improved in Rwanda. These results are shown in Table 6.

Table 6: How can the Quality of Narrative Reporting be Improved in Rwanda?

	%
By adopting international standards	21
By 'reforms in narrative reporting'	17
By training	4
By regulations	4
By making it obligatory	4
Did not answer	50
	100

The most popular suggestion shown in Table 6 was to 'adopt international standards' (21%), followed by 'reforms in narrative reporting' (17%). 'Training' (4%), 'regulation on narrative reporting' (4%), and 'making it an obligation to disclose narrative reports' (4%) were less supported. Fifty percent (50%) of the respondents did not answer this question.

A perusal of some annual reports in Rwanda indicates that even though there is no official legislation or requirements regarding corporate governance disclosures, companies in Rwanda are improving their non-financial reporting but the information included is still insufficient. For instance, in SONARWA's 2005 annual report, the company was certified IS0 9001:2000. The report states that the management system of SONARWA was audited and found to operate in accordance with the requirements of their management standards. In RDB's 2005 annual report, the following features relating to non-statutory reporting were present: the social-economic impact of the Bank's intervention, job creation, and human resource capacity building.

BRALIRWA Limited became the first domestic company to be listed on the Rwandan Stock Exchange on 31 January 2011. A perusal of its annual report indicates that the financial statements have been prepared for the first time in accordance with the IFRS and the requirements of the Rwanda Companies Act. This is an encouraging sign for corporate reporting in Rwanda.

Conclusions, Limitations and Areas for Further Research

According to the perspectives of the respondents, annual reports in Rwanda require improvement. Although a small majority of the respondents were of the opinion that their company's annual report was useful to users, a question probing the composition of the annual reports showed some shortcomings in the annual reports. They were also of the opinion that a sustainability report should form part of narrative reporting, and that current narrative reporting is not suitable in Rwanda. The respondents were aware that Rwandan corporate reporting is not similar to the IFRS. Respondents recognised the need to improve corporate reporting in Rwanda and felt that this could be achieved mainly by regulating the accounting profession and by adopting the IFRS.

As the study identified a number of gaps in Rwandan corporate reporting, the following questions can be posed.

- What steps can Rwanda take to improve the situation? Practically speaking, how can it adopt IFRS going forward? What are the steps to be followed and what should be the timeline?

- What are the implications of Rwanda not following IFRS? It can be posited that these may be:

    i. Lack of investment;
    ii. The inefficient allocation of resources (from an economic perspective, if investors are receiving incomplete information, they are less able to allocate their resources (capital/finances) to the most productive uses); and
    iii. Investor confusion (as they are not able to make meaningful comparisons using the information nor may they be fully aware as to which accounting framework is being followed).

The regulatory regime in Rwanda will need to see how best it can bring financial reporting up to the required standards which would be acceptable to users.

The limitations of this study are that due to the small number of professional accountants in Rwanda, combined with the relative infancy of the two main financial institutions (RSE and ICPAR), the questionnaire was simplistic and this cannot be considered a comprehensive survey on financial reporting in Rwanda. In addition, a number of the questions were not answered by the respondents probably due to their lack of experience and the infancy of the accounting profession. Further research could probe the reasons for this and other reasons for the respondents' perspectives with follow-up interviews. Finally, due to the lack of peer-reviewed research, it is not possible to compare this study with those of other authors. Increased research in the field of Rwandan Accounting will hopefully rectify this problem.

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Lesley Stainbank
School of Accounting, Economics and Finance
University of KwaZulu-Natal
South Africa
stainbankl@ukzn.ac.za

Théobard Ntukabumwe
School of Accounting, Economics and Finance
University of KwaZulu-Natal
South Africa
theobardnt@yahoo.fr