

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC)

Republic of Rwanda

ACCOUNTING AND AUDITING

June 19, 2008

Contents

Executive Summary

Preface

Acronyms and Abbreviations

I. Introduction

II. Institutional Framework

III. Accounting Standards as Designed and as Practiced

IV. Auditing Standards as Designed and as Practiced

V. Perceptions on the Quality of Financial Reporting

VI. Policy Recommendations

Executive Summary

This report is an assessment of the corporate sector accounting, financial reporting, and auditing practices within Rwanda. This ROSC is benchmarked to International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) and draws on international experience and good practices to assess the strengths and weaknesses of the institutional underpinnings of corporate financial reporting and make policy recommendations. This assessment is mainly aimed at preparing a road map for institutional capacity building including development of the accountancy profession for bolstering the corporate sector accounting, financial reporting, and auditing in Rwanda.

Rwanda is making considerable effort to align its accounting and auditing practices with internationally accepted standards and codes. Along with its growing economy, Rwanda must take effective steps for strengthening all the pillars of the infrastructure of accounting and auditing in line with the international good practices. The ROSC review findings reveal that there are varying compliance gaps in both accounting and auditing practices in Rwanda. These gaps stem from lack of clearer understanding among practicing accountants and auditors about the requirements of internationally accepted standards, inadequate technical capacities of the regulators, absence of implementation guidance, lack of independent oversight of the auditing profession, and shortcomings in professional education and training. The Institute of Certified Public Accountants of Rwanda (ICPAR) will assume the role of the self-regulatory professional accountancy body in the country.

The key areas of the policy recommendations made by the ROSC team include:

- Work towards transferring the functions of the Inspection Commission to an oversight body outside the ICPAR after five to seven years.;
- Updating and improving accountancy education and training with a greater focus on IFRS and ISA;
- Monitoring and enforcing compliance with IFRS in key sectors like banking and other financial institutions, and various other public-interest entities;
- Issuing and disseminating implementation guidance on applicable standards;
- Adopting the simplified reporting requirements for small and medium enterprises;
- Collaborating with regional and international professional bodies, and
- Enhancing the access, affordability and delivery of continuing professional education.

The policy recommendations in this report require a comprehensive implementation approach. Such implementation will require the cooperation of the Government, regulators, the accountancy profession, and other stakeholder groups.

PREFACE

Reports on Observance of Standards and Codes (ROSC) is a joint World Bank and International Monetary Fund (IMF) initiative that helps member countries strengthen the institutional underpinnings of the national financial system. The ROSC involves preparation of reports in twelve key areas.¹ The ROSC Accounting and Auditing (ROSC A&A) review exercise covers two of these twelve areas. ROSC A&A evaluates a country's accounting and auditing standards and practices using as benchmarks the International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA). It also uses international good practices as reference points for assessing the strengths and weaknesses of the infrastructure of corporate financial reporting regime of a country. Important pillars of the corporate financial reporting infrastructure are statutory framework, accounting profession, accounting education and training, accounting standards, auditing standards, and monitoring and enforcement of applicable accounting and auditing requirements.

The main objective of ROS A&A review exercise is to assist the development and implementation of a Country Action Plan (CAP) for strengthening all areas of a country's financial reporting infrastructure. Based on the unique country circumstances and stage of development, the CAP addresses the most significant areas where there is opportunity for improvement, with a focus on specific, realistic, and achievable objectives

The ROSC A&A was carried out in Rwanda between February and May 2008 through a participatory process involving various stakeholders. The report was updated on the basis of feedback from the Government in end-October 2008. The stakeholders include the Ministry of Finance and Economic Planning, the National Bank of Rwanda, the Office of the Auditor General, leading audit firms, banks, insurance companies, state-owned enterprises, professional accountants, and academics.

The Rwanda ROSC A&A was prepared by a World Bank team comprising M. Zubaidur Rahman, Program Manager (OPCFM); Otieno Ayany, Sr. Financial Management Specialist (AFTFM); and Ludovic Kabran, Senior Operations Officer (AFTFM).

¹ The twelve ROSC areas are data transparency, fiscal transparency, monetary and financial policy transparency, banking supervision, securities, insurance, payment systems, anti-money laundering and combating financial terrorism, corporate governance, accounting, auditing, and insolvency and creditor rights.

ACRONYMS and ABBREVIATIONS

ACCA	Association of Chartered Certified Accountants
BNR	Banque Nationale de Rwanda (National Bank of Rwanda)
CMAC	Capital Market Advisory Council
GDP	Gross domestic product
EDPRS	Economic Development and Poverty Reduction Strategy
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICPAR	Institute of Certified Public Accountants of Rwanda
IFAC	International Federation of Accountants
IFRC	International Financial Reporting Committee
IFRS	International Financial Reporting Standards (including IAS)
IMF	International Monetary Fund
ISA	International Standards on Auditing
NAS	National Accounting Standards
PRSP	Poverty Reduction Strategy Paper and
RCRSA	Rwanda Commercial Registration Services Agency
ROSC	Reports on the Observance of Standards and Codes
ROTC	Rwanda Over the Counter
SOE	State-owned enterprise

I. INTRODUCTION

1. This assessment of accounting and auditing practices in Rwanda is a joint initiative of the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting and includes both a review of both mandatory requirements and actual practice. The report uses International Financial Reporting Standards (IFRS)² and International Standards on Auditing (ISA)³ as benchmarks and draws on international experience and good practice in the field of accounting and auditing regulation.

2. Rwanda is a small, landlocked country in Central Africa with a population of 9 million and high population density (337 people per square kilometer). Rwanda became independent in 1962 after colonization by Germany (1899) and Belgium (1919). In 1961 its monarchical government was formally abolished by a referendum and the first parliamentary elections were held. Political turmoil over the sharing of power and access to opportunities resulted in explosions of ethnic violence, which have marked much of the recent history of the country. A civil conflict culminated in genocide between April and June 1994.

3. While the country is currently at peace, Rwandans continue to struggle with the legacy of the genocide. Since 1994, Rwanda has been able to maintain overall macro economic stability and implement extensive reforms that have contributed to its strong performance. Key reforms were implemented between 1995 and 2005 which impacted positively on the gross domestic product (GDP). The GDP growth has averaged 5 to 6 percent per year from 2002–2007.⁴ Inflation has been contained at less than 10 percent since 1997, with the exception of 2004 when it reached 12 percent. By 1998, GDP had recovered to its pre-1994 level. Economic growth was driven by the recovery in subsistence agriculture and a construction boom during the reconstruction phase. Rwanda economy has made a remarkable transition from reconstruction to development since the 1994 genocide.

4. In its Vision 2020 document, published in 2000, the Government of Rwanda established targets for GDP growth and poverty reduction to be achieved by the year 2020. These targets were to (a) raise real per capita income from US\$230 to \$900; and (b) reduce by half the poverty incidence. To reach these targets, the Government

² IFRS are issued by the International Accounting Standards Board (IASB), an independent accounting standard-setter based in London, United Kingdom. In April 2001, the IASB announced that it would adopt all of the International Accounting Standards (IAS) issued by the International Accounting Standards Committee (IASC). References to IFRS in this report also include IAS.

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

⁴ Rwanda Country Brief, World Bank, www.worldbank.org.

projected in its 2020 Poverty Reduction Strategy Paper (PRSP) that GDP growth would have to be in the range of 6 to 7 percent over the medium term.⁵ In line with this vision, the Government undertook reforms to liberalize the economy, improve the business environment, and invest in human capital. As a result, real GDP growth averaged around 7.4 percent over the period 1995–2005.

5. Rwanda is making considerable efforts to align its accounting and auditing practices with internationally accepted standards and codes. Corporate accounting and disclosure practices need to develop in line with a growing economy, as well as with international best practice. There are varying compliance gaps in both accounting and auditing practices. These gaps stem from inadequate understanding of ISAs and IFRS by professional accountants, inadequate technical capacities of the regulators, absence of implementation guidance, lack of independent oversight of the auditing profession, and shortcomings in professional education and training. The Institute of Certified Public Accountants of Rwanda (ICPAR) is at its infant stage. The law establishing the Institute (No. 11/2008 of 06/05/2008) became effective on August 1, 2008. The Minister of Finance and Economic Planning, as per provision of the Law, has appointed an interim Governing Council to launch operation of the Institute.

6. The contribution of the private sector to the economy and poverty alleviation remains limited; there are only about 400 enterprises in Rwanda, of which one-half have less than 50 employees. Private sector development remains hampered mainly by the high cost of infrastructure services and, to a lesser extent, by the weakness of the financial sector.

7. The institutional structure of a capital market in Rwanda is constrained in terms of types of institutions, financial instruments, and services. In view of the fact that conventional commercial banks (Bancor, Banque Commerciale du Rwanda, Banque de Kigali, Rwanda Development Bank, Cogebanque, Ecobank, and Finabank) dominate the financial scene, their services are limited to traditional loans and deposits, and foreign exchange transactions and transfers. Two financial institutions (Union des Banques Populaires du Rwanda and Rwanda Housing Bank) and more than 100 micro-finance institutions are the other players in the country's financial sector. The insurance sector is equally thin with Société Rwandaise D'assurances (SORAS), Société Nationale des Assurances au Rwanda (SONARWA), and Compagnie Générale d'Assurance et de Reassurance (COGEAR) being the key players. A Financial Sector Development Plan is being implemented at the present time, and it has been addressing these weaknesses in the financial sector.

8. In order for Rwanda to develop a competitive and efficient financial sector for the growth of a vibrant private sector, its financial system must be reasonably robust to earn investors' confidence. Among other necessary attributes, a mechanism that ensures a high-quality financial reporting system is crucial in this respect. A strong financial reporting regime for corporate entities in both private and public sectors will benefit the Rwanda economy in various ways, including:

⁵ Country Economic Memorandum, World Bank, October 2007.

- *Contributing to financial sector development* through strengthening the country’s financial architecture and helping reduce the risk of financial crises and corporate failures, together with their associated negative economic impacts that have been witnessed in many industrialized and developing countries;
- *Empowering local communities to own and manage their development process* by broadening the financial system through strengthening microfinance institutions;
- *Increasing foreign direct investment*, which can be achieved through greater confidence in, and improved comparability of, financial information;
- *Facilitating economic integration on an international level*, through further alignment of Rwanda’s national standards and codes with those of its main trading partners;
- *Improving access to financing for the small and medium enterprise sector* by providing banks and other financial institutions with standardized, useful, and reliable information.

9. As Rwanda moves toward further liberalization and deregulation to further enhance their business environment, enhanced financial transparency and improved accounting and auditing practices are necessary. In this context, this ROSC sets out policy recommendations to enhance the quality of corporate financial reporting and foster a financial reporting platform conducive to sustainable private and financial sector growth, and to increase access to global financial markets.

II. INSTITUTIONAL FRAMEWORK

10. This report outlines the legal principles applicable with regard to accounting, auditing, and financial reporting. Primarily an introduction to the issues, the ROSC is neither meant to be an exhaustive rendition of the law nor to give legal advice.

A. Statutory framework

11. **A draft Companies Act has been prepared which has not yet been enacted.** The draft Companies Act aims at addressing various shortcomings of the existing Companies Act (1988) with respect to corporate financial reporting. The draft Act provides requirements for preparation, presentation, and publication of financial statements, disclosures, and auditing for the companies incorporated under the Act. The Act prescribes the basic contents and form of financial statements and requires that the financial statements of the companies, except small private companies, be audited annually. The Companies Act in Rwanda provides for five types of companies: general partnerships (SNC); simple limited partnerships (SCS), limited partnership with shares (SCA); private limited liability company (SARL) and public limited company (SA).

12. **The Banking Act contains accounting and auditing requirements in addition to those set in the Companies Act.** The National Bank of Rwanda (BNR) regulates financial reporting by banks and non-bank financial institutions and issues accounting instructions governing the treatment of specific transactions—e.g. provisions for nonperforming loans. In the exercise of powers conferred to it by its statutes, the Banking Act, and other legal provisions, and in order, particularly, to preserve depositors' and other creditors' interest, the National Bank of Rwanda is empowered to enact regulations, to issue instructions, and take decisions that banks, insurance companies, and other financial institutions are bound to comply with. It determines modalities for their implementation. The accounting and auditing requirements, as outlined in the Banking Act, are in addition to those set by the Companies Act. The National Bank of Rwanda requires these institutions to designate at least one external auditor chosen from a list regularly drawn up by it. At present, these instructions do not define who can be appointed as an external auditor. Going forward, only those auditors with license issued by the Institute of Certified Public Accountants of Rwanda should be eligible for appointment. External auditors of banks are required to follow the generally prevailing standards of their profession coupled with the regulations, instructions, and decisions of the Central Bank. The term of an auditor's mandate is three years⁶ renewable only once.

13. **The Rwanda Stock Exchange which commenced operations in January 2008, does not have any monitoring and enforcing mechanism with respect to accounting and auditing standards.** The Stock Exchange is operating under Rwanda Over the Counter (ROTC) rules and regulations developed by the Capital Market Advisory Council (CMAC). It trades in bonds (over the counter) under the oversight of the CMAC. Trading in equities is expected to begin at a future date. The ROTC official document provides for disclosure and listing requirements for all issuers of securities through the capital market. In addition, it also has requirements for members to file mandatory reports with CMAC together with trading, clearing, and settlement rules.

14. **At present there is no legal mandate for the application of IFRS and ISA for private sector corporate financial reporting, except for the banks and other financial institutions.** However, the draft Companies Act (Article 412) mandates the application of IFRS and ISA with regard to financial reporting by the registered companies. At present, the banks and other financial institutions are required by the National Bank of Rwanda to follow IFRS. The newly established ICPAR has been legally mandated to prepare accounting and auditing standards; and these will be issued by Ministerial Order..

15. **The Constitution of the Republic of Rwanda and the Law 05/98 empowers the Auditor General to conduct audits of state-owned enterprises (SOE).** Article 183 of the Rwanda Constitution and the Law no. 05/98 published on June 4, 1998 provide for functional autonomy of the Auditor General in discharging responsibilities with regard to undertaking audit functions of state-owned enterprises. The SOE audits can be

⁶ Article 39 of Law no. 08/99 of 6/18/1999 relating to regulations governing banks and other financial institutions.

undertaken directly by the Office of the Auditor General or through independent audit firms that are appointed by the Auditor General.

16. **There is a need to strengthen capacity of the Office of Auditor General in order to execute the mandate of the Office.** Most of the staff in the Office of the Auditor General who are responsible for providing audit services are not adequately exposed to relevant public sector accounting and auditing pronouncements by the International Federation of Accountants (IFAC). Failure to retain well trained audit staff is a major constraint in the Office of the Auditor General.

17. **The Companies Act entitles the external auditors to attend the annual general meeting.** The Companies Act spells in detail the appointment of auditors, their functions and duties, tenure of office, their remuneration, and reporting standards.

18. **A well-regulated banking sector is crucial for Rwanda's efforts to achieve sustained economic development.** Rwanda's banking regulations are reasonably sound and compliant with international norms.

B. The Profession

19. **Until August 2008, there was no national professional accountancy body in Rwanda.** There is a small group of accountants who have, until recently, served as the promoters of national accountancy profession. The total number of qualified accountants in Rwanda has grown from 14 in 2004 to about 45 in October 2008.

20. **Except for larger entities, the corporate sector in general does not have access to professionally qualified accountants.** The accountants for many corporate entities lack the required skills to prepare financial statements in accordance with applicable accounting and reporting requirements. Consequently, in many cases compliance by preparers of financial statements with applicable requirements is limited. The legal and regulatory limitations provide little incentive for company directors to ensure that financial statements are prepared as per established standards.

21. **The actual market for auditing services in Rwanda is relatively small, due to a relatively low demand.** Most financial sector entities as well as larger corporate entities are audited by audit firms affiliated with international networks but not necessarily incorporated in Rwanda. As for small and medium enterprises, very few have their financial statements audited. For those small audited entities, many observers question the reliability of the process of such audits. The practicing audit firms in the country are very small in size and need capacity building with respect to quality of audit.

C. Professional Education and Training

22. **The current accountancy education and training capacity is inadequate to meet effectively the needs of the Rwanda economy.** Universities offer an accounting diploma and degree programs; however, those who aspire to gain professional accounting

qualification must look abroad for this certification. The UK-based Association of Chartered Certified Accountants (ACCA) courses are the most popular. About 150 candidates from Rwanda are registered and at various stages of taking the ACCA examinations. The School of Finance and Banking continues to be the major player in the education of professional accountants. However, it is in serious shortage of academic staff, teaching materials, and other logistical support. The Kigali Institute of Management also offers education and training for professional accountants.

23. **Professionals working in small accountancy firms find it difficult to stay updated on recent developments in accounting and auditing.** These practitioners are constantly struggling to keep their client base and earn enough to stay afloat. In most cases, they do not have the money and time for training programs. Many practitioners in small and medium firms in Rwanda are also handicapped by their lack of access to current literature on applicable accounting and auditing standards.

24. **The accounting curricula do not focus on IFRS and ISA in higher education accounting degree programs.** The academic education in accounting also lacks adequate coverage on professional values and ethics. The curricula are mainly restricted to teaching accounting technicalities and basic procedural aspects of auditing. Students do not obtain required exposure of international best practice with regard to accounting and auditing. Moreover, most accounting textbooks lack adequate focus on the practical application of IFRS and ISA, and the international dimension of accounting and auditing. There is a lack of 'local' adoption and recognition of training that meets the required standards, which should be benchmarked to the appropriate international educational standard.

D. Setting Accounting and Auditing Standards

25. **There is no arrangement outside the banking and financial sector, for adopting IFRS and ISA, and facilitating their implementation.** According to the new Law, the ICPAR is authorized to prepare Rwanda's own accounting and auditing standards consistent with IFRS and ISA respectively. There is a risk that development of national standards based on international standards may sometimes distort the essence of the requirements of international standards.

26. **Auditors often decide the accounting policies to be followed by the clients.** Most companies follow the advice of their auditors on how to prepare financial statements. Most auditors also tell their clients how to prepare financial statements.

27. **In the absence of any requirement on the use of ISA or any other authoritative standards,** most auditors use their *knowledge* in conducting audits. Some apply ISA while others apply *generally accepted auditing standards*. This may be due to the absence of any regulatory framework of auditing. Moreover, there is a need for upgrading knowledge and skills in the auditing profession.

E. Ensuring Compliance with Accounting and Auditing Standards

28. **Only banking and financial institutions seem to have an IFRS reporting framework.** A review of reports prepared by banks does not reflect full compliance of IFRS. The National Bank of Rwanda prescribes IFRS for all banking and financial institutions as a reporting framework. This followed the due diligence conducted in the banking sector in 1998 and subsequent development of an accounting plan for banks launched in 2003 seeking to introduce IFRS within the banking sector.

29. **No effective mechanism exists in the draft Companies Act to enforce requirements for accounting and financial reporting.** The draft Companies Act prescribes weak legal sanctions for violations. In many cases, company directors are not fully aware of their responsibilities for ensuring that financial statements present true and fair view. According to the new Law, an inspection commission will be established under the ICPAR with the responsibility of monitoring compliance with accounting and auditing standards.

30. **Financial statements prepared by insurance companies do not receive effective monitoring and enforcing actions.** The National Insurance Commission was recently disbanded and replaced by the BNR Department of Supervision of Non-Banking Institutions. Despite the legal creation of the new department, it still lacks the capacity to monitor compliance with financial reporting requirements of insurance companies. The inspectors perform offsite supervision of financial statements of insurers; however, the focus is not on monitoring compliance with IFRS and ISA. .

31. **The technical capacity of the BNR Department of Banking Supervision is insufficient for monitoring and enforcing accounting and financial reporting requirements.** Primarily to ensure compliance with prudential regulations, the Department conducts both offsite and onsite supervision of banks and other financial institutions. It examines financial statements, approves the appointment of external auditors, reviews any communication from the external auditors, and holds meetings between banking supervision staff and a bank's external auditors. The Department of Banking Supervision lacks the technical capabilities for ensuring the practical application and compliance of accounting and auditing standards.

32. **Lack of implementation guidance constrains full compliance of accounting and auditing standards.** Although the Companies Act refers to IFRS and ISA, no organization issues guidance on their implementation. This contributes to the knowledge gap among preparers and auditors of financial statements. Lacking access to modern audit practice manuals, many audit practitioners are unable to deal with important concepts, such as audit risk, audit planning, internal control, materiality, documentation, going concern and quality control. Any guidance should incorporate cases and illustrations relevant to Rwanda and should be focused on industry-specific experiences.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

33. The ROSC team conducted a review in order to analyze the significant differences between Rwanda's *plan comptable national (issued in 1978)* and IFRS (the 'standards gap'). Also reviews of sample financial statements were conducted in order to determine the degree of compliance with the applicable accounting requirements (the 'compliance gap').

34. **The accounting practices in Rwanda vary from institution to institution and differ from IFRS.** Of the 41 financial statements reviewed by the ROSC team, 15 were non-audited and 26 were audited. In the sample of the 15 non-audited financial statements:

- 11 did not apply any principle or standards,
- 1 applied local legislation that was not defined,
- 1 applied banking laws and regulation,
- 1 applied generally accepted accounting principles (not defined),
- 1 applied IFRS.

In the sample of the 26 audited financial statements:

- 8 did not apply any principle or standards,
- 8 applied local legislation applicable in Rwanda (not defined),
- 1 applied banking laws and Companies Act,
- 3 applied generally accepted accounting principles (not defined),
- 6 applied IFRS.

35. **The review of the audited financial statements revealed compliance gaps.** Compliance gaps refer to the differences between applicable standards and actual practice. The 26 sample sets of financial statements that were reviewed by the ROSC team had been issued by 1 central bank, 1 development bank, 8 commercial banks, 10 state-owned enterprises, 2 insurance companies, and 4 privately held industries. The ROSC team also conducted interviews with corporate accountants, auditors, academics and regulators. The review focused on issues of presentation and disclosure and also covered compliance with "recognition and measurement" requirements of accounting standards, which is not detectable through a review of financial statements. From the review and interviews, the ROSC team learned of circumstances when there was material non-compliance with applicable accounting standards and when the reliability of related audit opinions was questionable. The ROSC team found the following compliance gaps in the review:

- **Accounting framework.** The accounting framework adopted by the BNR-regulated financial institutions varies with some banks reporting under the generally accepted accounting principles (not defined) while others report under IFRS.

- **Recognition and measurement of financial instruments.** The accounting policies adopted by some banks for loans and advances are in compliance with the prudential guidelines set out by the BNR Instruction No 09/2003. These policies do not comply with IAS 39, *Financial Instruments: Recognition and Measurement*. Similarly, most banks' accounting treatment for investments in treasury bills and long-term government stocks does not comply with determination of impairment, specifically in relation to the impairment of loans and advances, under IAS 39.
- **Impairment losses.** Potential failures to recognize impairment losses on property, plant and equipment could result in overstated assets. It is not clear from the financial statements whether the impairment tests required by IAS 36, *Impairment of Assets*, were carried out adequately.
- **Related party.** Many entities, including some financial institutions, omitted important disclosures such as the relationship and transactions, pricing policies, the volumes of related party transactions, and the corresponding amounts. Adequate disclosure of material related party relationships and transactions is essential to users' understanding of a company's financial position and results, and for minority investors' confidence that they will receive a fair treatment. Inadequate disclosure in this regard leads to non-compliance with IAS 24, *Related Party Disclosures*.
- **Consolidated financial statements.** Companies in Rwanda do not prepare consolidated financial statements because there is no legal requirement for consolidation. In the absence of consolidation, the financial statements fail to provide an idea about their significant subsidiaries, proportion of ownership interest, proportion of voting power held, and nature of investments in subsidiaries. Not preparing consolidated financial statements departs from compliance with IAS 27, *Consolidated and Separate Financial Statements*.
- **Employee benefits.** Inadequate disclosure as to whether actuarial or any other forms of valuation had been made to quantify outstanding liabilities for post-employment benefits does not adhere to the requirements of IAS 19, *Employee Benefits*.
- **Contingent liabilities.** Some companies did not adequately disclose contingent liabilities, making their financial statements noncompliant with IAS 37, *Provisions, Contingent Liabilities, and Contingent Assets*.
- **Property, Plant and Equipment.** In cases where fixed assets were revalued, detailed IAS-required disclosures – such as measurement bases used for determining the gross carrying amount and reconciliation of the carrying amount at the beginning and at the end of the period – were not available and thus noncompliant with IAS 16, *Property, Plant and Equipment*.
- **Additional disclosure by banks.** Despite a higher degree of compliance with IFRS and IAS by banks than other entities, there still exists non-compliance with requirements of IAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*. Most banks did not disclose (a) expenses related to

fee and commission income, (b) fair values of each class of financial assets and liabilities, (c) information relating to loans and advances on which interest is not being accrued, (d) amount of significant net foreign currency exposures, and (e) contingencies and commitments arising from off balance sheet items.

36. **Companies and their auditors face a number of practical difficulties in implementing IFRS.** Accounting practice is often influenced by taxation issues. The ROSC team found instances where preparers of general purpose financial statements departed from IFRS and complied with tax rules as the method of accounting treatment. These companies manage their profits in order not to incur taxation penalties. Discussion by the ROSC team with representatives of companies and audit firms revealed IFRS implementation problems. Most of these problems arise from the lack of adequate skills among the corporate accountants who find it difficult to prepare IFRS-compliant financial statements. This issue is pervasive in the entire corporate sector.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

37. A ROSC team review of 26 audit reports reveals that compliance gaps exist and that quality varies from one firm to the next.

38. **Auditing practice for banks is conducted under the close scrutiny of the National Bank of Rwanda.** The National Bank of Rwanda has created various instructions to guide the audit reviews by borrowing from various international standards on auditing. It has developed the terms of reference for bank audits and clears all firms that audit banks and other financial institutions. This has led to a limitation where one audit firm has been auditing most of the commercial banks.

39. **The Office of the Auditor General for State Finances conducts audits of state-owned enterprises.** The Office of the Auditor General derives its mandate from the constitution and the law creating it to carry out audit of state-owned enterprises. The Auditor General's reports make no mention of any specific standards but refer to the legal provision mandating the Office to undertake the audit assignment.

40. **Absence of implementation guidance hinders application of auditing standards.** Audit firms in Rwanda are limited liability companies that increased in numbers to fill the gap created by growing business opportunities. The local firms—either sole proprietorship or partnerships of not more than two persons—in practice have learned their trade from brief associations with the local affiliates of international networks of accounting firms; and have continued with the basic knowledge acquired during these associations. Only two international firm networks have presence in Rwanda; other three commute from outside locations. In practice, with the exception of audit firms associated with the international network of accounting firms, most audit firms have no access to high-quality audit practice manuals. Lacking practice-oriented methodological guidelines, auditors generally find it difficult to handle audit risks, audit planning, internal control, documentation, going concern, and other important concepts.

It is difficult to apply normal audit procedures regarding related party transactions due to the lack of legal requirements concerning group accounting and consolidation.

41. **Lack of understanding by company directors and management about the purpose of audits sometimes makes it difficult for auditors to obtain appropriate audit evidence.** Many auditors claim that some directors and members of top management often fail to appreciate the purpose and value of auditing. Such a situation limits access to evidence to form professional judgments. Despite the arduous efforts by some auditors to carry out audits in accordance with international best practice, they view this task as a major constraint in discharging their professional responsibilities.

42. **In general, application of auditing standards differs among audit firms.** To better understand the actual auditing practices, the ROSC team interviewed practicing auditors and experienced accountancy professionals and had facilitated discussions with the partners representing in the Rwanda context, large and medium audit firms, from which the following points were made on auditing practices in Rwanda:

- Lack of knowledge of theoretical and practical application of standards, coupled with no independent practice review mechanism and disciplinary procedures, adversely affects audit quality.
- Documentation practices fail to provide audit evidence to support the audit opinion, mostly in the audit of small and medium enterprises.
- Meaningful analytical procedures are difficult due to the absence of industry information.
- Apart from the firms with international affiliations, most firms do not comply fully with ISA on quality control due to lack of capacity. Second-partner reviews are generally not done.
- Smaller audit firms find it difficult to bear the cost of implementing auditing standards in an adequate fashion.
- In many cases, auditors bring material deficiencies to the attention of management through a management letter rather than giving qualified audit opinion.
- Shortage of expertise in information technology (especially in small and medium firms) erodes audit quality. Reliance is placed on work of experts, without assessing the adequacy of such work, and the expert's competence and objectivity.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

43. **The quality of audited financial statements is a concern to users of financial statements.** Discussions with some stakeholders, including bankers, revealed concerns about the quality of financial reporting. There was a widespread view that the low-level skills among accounting professional and the lack of enforcement mechanisms contribute

to noncompliance with established accounting requirements and auditing standards. Most interviewees shared the opinion that improving the quality of financial reporting requires a robust regulatory regime and effective enforcement mechanisms for ensuring compliance with accounting and auditing standards and auditors' professional code of ethics.

44. **The users perceive financial statements audited by large firms meet higher standards of financial reporting.** Interviews and discussions revealed that a higher degree of reliance is placed on the financial statements that are audited by the member firms of international accounting networks. Contrary to that position, some stakeholders considered an audit in most cases does not add value but is only a requirement for the company to win a contract or to obtain a bank loan.

45. **The financial statements of companies are not readily available due to the perception that they are confidential.** With the exception of banks and insurance companies, companies were reluctant to share copies of financial statements with the ROSC team. There is a general perception among the owners and top management of companies that the information in financial statements is confidential and should not be shared. This may reflect a secretive corporate culture. It also indicates attaching relatively low importance to the use of financial information in the decision-making process. Many companies view the preparation of financial statements as merely ritual and are mainly necessary either for taxation purpose or apparent compliance with regulatory requirements.

46. **Many stakeholders perceive auditors' involvement in both audit and tax advocacy as a conflict of interest and therefore a concern to the auditors' independence.** In Rwanda, statutory auditors are not prohibited from providing some non-audit services, including tax advocacy and representation before tax authorities. There is a strong perception among the stakeholders that such involvement may pose a threat to auditors' independence.

VI. POLICY RECOMMENDATIONS

47. The policy recommendations outlined in this section emerge from the review of accounting and auditing practices in Rwanda and require a comprehensive, holistic approach to implementation. Based on the successful experience of other countries, the ROSC team recommends that there should be collaboration amongst the Government, regulators, the accountancy profession, and other stakeholder groups for developing and implementing a country strategy and a detailed country action plan that clearly sets out the key actions and allocates responsibilities for implementing the necessary reforms. The action plan should indicate the resources necessary for successful implementation. The government, policymakers, and development partners should work together to secure those resources so as to achieve the common goal of enhancing the quality and availability of financial information in Rwanda.

48. The recommendations of this ROSC are interrelated and mutually supportive, designed to collectively improve the financial reporting environment in Rwanda. For example, good accounting standards are jeopardized if practitioners do not understand how to translate them into journal entries; a rigorous statutory and regulatory framework is unlikely to be effective if it is not enforced. Additionally, some recommendations will not have an immediate effect but still remain of high priority if the financial reporting environment in Rwanda is to be upgraded to international standards within a reasonable timeframe.

49. The following points have been taken into account while designing the policy recommendations:

- Promoting a gradual process of improvement whereby public interest entities will lead the reform process;
- Strengthening the country's financial architecture aimed at reducing the risks of financial market crises and their allied negative impacts;
- Enhancing the business climate and bolstering domestic and foreign direct and portfolio investment in the private sector;
- Strengthening the stability and competitiveness of the banking and non-banking financial sectors, and mitigating the risk of crises due to loan collection problems and weak capital base;
- Building capacities for professional accountants and auditors and regulators;
- Emphasizing the case for strengthening capacity of national institutions with support from sub-regional/regional institutions;
- Achieving greater financial transparency in the corporate sector and limiting tax evasion through ensuring proper calculation of corporate profits;
- Encouraging greater transparency in both state- and private-owned enterprises, thus allowing shareholders and the public-at-large to assess management performance and influence its behavior;
- Aligning the normative and legal framework of financial reporting, accounting, and auditing with the best international practices;
- Facilitating small and medium enterprises access to credit by encouraging a shift from collateral-based lending decisions to lending decisions based on the financial performance of the prospective borrower, thereby supporting growth in this sector; and
- Helping to ensure that the financial reporting and auditing rules applicable to different types and sizes of entity are appropriate to the needs of those entities and the users of their financial statements.

Without attempting to provide a detailed tactical design for reforms, the ROSC sketches the policy recommendations to support the implementation of accounting reform and ultimately enhance the quality of corporate financial reporting.

50. The policy recommendations are based on the assumption that long-term country objectives include thorough modernization of the accounting and auditing professions, and development of a business environment conducive to preparation of transparent financial information compliant with international standards. As set forth in the ROSC, achievement of these objectives requires continuous reorganization and improvement of Rwanda's legal framework, institutions, accounting and auditing professions, as well as change in its business culture and education system.

51. However, policies should not be developed and enacted without giving due regard to a country's ability to carry out such policies (both in terms of capacity and resources). A relatively lenient rule that is robustly and consistently enforced is preferable to a good, rigorous one that is unenforceable. An enforceable lenient rule can be made more rigorous progressively as circumstances require. The policy recommendations that follow can be carried out in the short to medium term and are conducive to Rwanda's long-term objectives.

A. Institutional Capacity Strengthening

52. **The ICPAR should implement important standard setting functions to ensure smooth application of IFRS and ISA.** Upon its commencement, the ICPAR is expected to discharge the following responsibilities:

- Regulate the accountancy profession;
- Promote the competence of its members;
- Establish a due process through which IFRS and ISA can be adopted locally, including contributing to the development of international standards by disseminating and commenting on IASB and IFAC Exposure Drafts;
- Disseminate applicable standards and related implementation guidance to the members of the profession and other stakeholders in order to ensure that implications of these standards are understood properly.
- Support implementation through training and enforcement

The ICPAR will need assistance to organize an internationally comparable professional accountancy body. ICPAR and other stakeholders should refer to related IFAC guidance "Establishing and Developing a Professional Accountancy Body – Second Edition." Its governance structure should be established in line with international good practices; and its capacity should be built in a way that it acquires capacity to comply with the 7 IFAC Statements of Membership Obligations. In this regard, there is an urgent need for establishing a twinning arrangement between the newly established Institute of Certified Public Accountants of Rwanda and a strong IFAC member accountancy body. With the assistance of the twinning partner, ICPAR should apply for IFAC membership within two to three years. The ICPAR should carry out its responsibilities for adoption and dissemination of IFRS and ISA. Special focus should be given on development of a core group of national experts and a sustainable arrangement for development and

dissemination of implementation guidance on IFRS and ISA. ICPAR should make maximum use of the existing guidance such as IFAC’s “Guide to Using International Standards on Auditing in the Audit of Small- and Medium-sized Entities” Moreover, ICPAR should develop and implement its own professional qualification examination and training schemes with the same assistance.

53. Strengthen the monitoring and enforcement mechanism. High-quality financial reporting cannot be ensured by the lone act of adopting international standards. To a large extent, the quality depends on the designing and implementation of a proper monitoring and enforcement system. There are three crucial links in the enforcement process, and each must be strengthened. First, company directors with legal obligations to prepare the financial statements must ensure that accounting staff apply standards properly. Second, statutory auditors must discharge their professional responsibilities independently in order to provide assurance that financial statements comply with all applicable standards and portray “true and fair” view of enterprises’ conditions and results of the operations. Third, the accounting profession and statutory regulators must ensure proper compliance with the standards and consistently take actions against violators. To ensure effective enforcement, the regulators in particular need adequate capacity, authority, and independence. Since they cover a wide range of sophisticated and complicated activities, their actions should not be constrained by lack of appropriate human and financial resources. Strengthening the enforcement mechanism through increasing capacity of the regulators and granting them more authority in dealing with infractions of accounting and auditing standards is particularly important for Rwanda to supplement Government’s efforts to promote investment and to consolidate a sound financial sector. Any capacity building effort should focus on:

- Recruiting technically qualified people in the respective regulatory bodies, such as the Bank of Rwanda, the Institute of Certified Public Accountants of Rwanda, the Banking Supervision Department, and Office of the Auditor General;
- Providing meaningful IFRS theoretical and practical training to the staff of the regulatory bodies so that they can enforce applicable accounting standards;
- Providing training to corporate accountants in the public interest entities highlighting the practical applications of IFRS in order to build their technical capacities to prepare IFRS compliant financial statements; and
- Facilitating access of smaller audit firms to the materials on recent developments in auditing practices, in particular, the practical application of ISAs.

54. Take steps for improving the capacity of the financial sector regulators. The bank supervision department insurance regulator, and the capital market advisory council should further strengthen their capacities to conduct in-depth review of financial statements of banks and insurance companies for determining the degree of compliance with the applicable standards, not only in appearance but also in substance. Capacity improvement of financial sector regulators should focus on recruiting technically

qualified personnel, practical training on implementation of IFRS and ISA, and providing administrative support and logistical arrangements. Furthermore, these regulators should be independent and have adequate authority to impose administrative sanctions for infractions. In order to supplement capacities of financial sector regulators in particular to detect infractions, auditors should be prepared to play a “whistle-blowing” role in order to provide early signals for initiating necessary corrective measures by the regulators. Since the financial sector’s vulnerabilities can have quick multiplier effects, appropriate whistle-blowing by auditors would help to make the financial sector regulation more efficient and effective. Added to this benefit, there could be a synergy between the requirements of prudential regulations and those for the general purpose financial reporting. In addition, capacity of the Rwanda Revenue Authority should also be improved with regard to ensuring reliable corporate financial reporting by the tax payers.

55. Strengthen the technical capacity of the Office of the Auditor General. It is important to ensure high quality audits. Immediate steps should be taken to recruit and retain experienced professionally qualified accountants for enabling the Office of the Auditor General to execute its mandate. The staff of the Office of the Auditor General should be given adequate training on practical implementation of IFRS, IPSAS and ISA. Necessary arrangements should be put in place so that knowledgeable and experienced auditors can be retained by the Office of the Auditor General.

56. Take steps for building technical capacity of audit firms. There should be an initiative for assisting small-and medium sized audit firms to develop capacity for providing quality audit and assurance services, and also to take necessary steps for developing viable audit practices. Following a review of audit quality and detailed discussions with the partners of individual audit firms, specific recommendations should emerge and steps taken to ensure compliance with IFAC requirements on audit quality control, and to assist individual audit firms in building capacity regarding quality assurance arrangements.

57. In essence, the capacity building exercise should focus on the following measures through regional integration initiatives wherever applicable:

- Recruiting and retaining technically qualified people in the Office of the Registrar General, Bank of Rwanda, Banking Supervision, and Office of the Auditor General;
- Providing IFRS theoretical and practical training to the staff of the regulatory bodies so that they can enforce applicable accounting standards;
- Imparting training to the corporate accountants in public interest entities, highlighting the practical applications of IFRS in order to build their technical capacities to prepare IFRS-compliant financial statements; and
- Facilitating access of smaller audit firms to the materials relating to the recent developments in auditing practices, in particular the practical application of ISA.

B. Preparation and Filing of Financial Statements

58. **Require full IFRS compliance by all public interest entities.** Public interest entities should be defined with consideration of issues relevant to Rwanda. The Companies Act should require that only public interest entities prepare IFRS-compliant financial statements that are made available to the public. Considering that the capital market is still at an early stage of development in Rwanda, financial transparency in the corporate sector would receive a significant boost if the financial statements of large but not listed companies were available to investors, banks, and the public in general. Public availability should be ensured through the Rwanda Commercial Registration Services Agency (RCRSA).

59. **Adopt the IASB's simplified financial reporting requirements for small and medium enterprises.** It is commonly acknowledged that financial reporting requirements for small and medium enterprises, the vast majority of companies in Rwanda, should be commensurate with their smaller size, simpler transactions, and narrower range of stakeholders. In this context, the ICPAR should adopt the IASB's simplified financial reporting framework and adjust it to the Rwanda context (i.e., one that would require lesser-level disclosure and eliminate some of the most complex options provided in IFRS).

C. Monitoring and Enforcement of Accounting and Auditing Standards

60. **Build capacity of the proposed Inspection Commission to put in place arrangements for monitoring and enforcement of accounting and auditing standards.** Capacity building should be carried out in line with international good practices. Specifically, focus should be given on the following aspects.

- ***Audit practice review.*** With an oversight mandate, the inspection commission would be responsible for conducting practice reviews of the auditors of public interest entities, ensuring each firm is reviewed at a reasonable and regular interval. After completion of the initial review, recommendations should be provided to the audit firms for overcoming detected shortcomings concerning quality assurance arrangements. The practice review should evaluate an audit firm's quality assurance arrangements, its audit approach, and the working papers with regard to selected audit engagements. The policies and procedures for carrying out audit practice review activities would be developed by the audit inspection commission with support from regional and international sources.
- ***Review of financial statements.*** The inspection commission should undertake review of financial statements for identifying noncompliance and ensuring enforcement with regard to applicable accounting standards. The policies and procedures for carrying out monitoring activities should be developed by the audit review board with support from regional and international sources.

- **Investigation.** Valid complaints against auditors and audit firms, and any irregularities identified from the reviews of financial statements and audit practices, should be investigated.
- **Disciplinary power.** Following reviews, steps should be taken for appropriate sanctions on the preparers and auditors of financial statements.

61. **Strengthen governance mechanism within public interest entities.** Corporate entities, having significant public interests in Rwanda should be required to establish audit committees. These audit committees can play an important role in monitoring the effectiveness of audit process, especially with regard to auditor’s compliance with the independence requirements.

D. Improving Professional Education and Training

62. **Strengthen higher educational institutions’ curricula in the field of accounting and auditing.** In order for future practitioners, especially would-be auditors, to have a sufficient academic background in the field of accounting and auditing, the accounting degree curricula in higher educational institutions should be harmonized with professional requirements at the national level. In that regard, guidelines should be established consistent with international good practices. Furthermore, professional accountants should be required to follow continuing professional development programs to improve and update their knowledge of international standards and practices in the field of accounting and auditing; which should be implemented and monitored by the ICPAR.

63. **Initiate industry-specific training programs.** Due to the unique nature of the insurance business, there is a serious shortage of qualified people in Rwanda with adequate knowledge of industry-focused accounting and auditing standards. Training programs should be developed and offered to the accountants and auditors involved in the insurance industry with focus on specific issues relating to the application of IFRS and ISA in the insurance industry.

64. **Implement a training-of-trainers program for sustainable transition to IFRS.** A program should be designed and implemented giving special emphasis to developing a core group of IFRS experts who would take the lead in putting in place a sustainable arrangement for dissemination of knowledge on practical application of IFRS. The core group of experts should make the commitment to (a) take active part in lecturing at the higher educational institutions and in continuing professional development programs to be organized by the new professional accountancy body and (b) writing and disseminating guidance notes on proper implementation of IFRS using local cases.

E. Others

65. **As a means to safeguard auditor independence, put in place an arrangement for rotation of audit engagement partner.** Arrangement should be made so that an

audit firm is required, after conducting audit for one company for a specific number of years, to propose a new partner with responsibility for that particular audit engagement. In cases when an auditor is sole practitioner, the company would need to appoint a new auditor.

66. Introduce awareness programs for improving the degree of compliance with accounting requirements by the public interest entities. The ICPAR in collaboration with leading audit firms in Rwanda should work to design an awareness program on the importance of compliance with accounting and auditing requirements. Shareholders and top management of public interest entities should be briefed on their responsibility regarding compliance with standards and on enforcement policies. These programs should include case studies demonstrating strengths and weaknesses of financial reporting in Rwanda, emerging international developments, and the role of transparent financial reporting in attracting both strategic and portfolio foreign investments.