

CHAPTER TWO

INTERNATIONAL ACCOUNTING PATTERNS, CULTURE, AND DEVELOPMENT

Chapter Objectives

- Discuss different ways to identify and classify accounting systems internationally
- Examine the key dimensions of national culture and how they influence behavior in work situations
- Identify accounting values that influence comparative accounting practice
- Show how cultural values and accounting values relate to each other in the development of accounting standards and practices worldwide

INTRODUCTION

Although there is a growing awareness of the varying influences of environmental factors on accounting development in a global context, many experts also realize that there may be systematically different patterns of accounting behavior applicable to various groups of countries. In this chapter we will examine the extent to which we can identify and classify accounting systems internationally. To assess whether there are systematic similarities or differences in accounting systems that may enable certain countries to be classified together, it is necessary to determine an appropriate scheme of classification. In essence, the classification of accounting and reporting systems, as in the case of political, economic, and legal systems, should sharpen our ability to describe, analyze, and predict the development of accounting systems. Such information is likely to provide useful input for making

Strategic Decision Point

Different accounting patterns of behavior can be identified which are the outcomes of many years of development influenced by factors such as cultural values, legal systems, political orientations, and economic development. The challenge now is to adapt what has served well in the past to the new global imperatives of transparency and credibility of accounting in order to facilitate efficient flows of capital to the world's financial markets. To do this requires recognition that tradition and culture shape accounting thought in a country and that change is more likely achieved when it is truly informed by an understanding of that country's heritage. In Germany and Japan, for example, the accounting profession's role in standard setting has been relatively minor compared to that of the United States and United Kingdom. Thus, new institutions have only recently been established which incorporate significant professional input to standard setting in a way that harmonizes with IASB governance structures.

strategic planning and control decisions and for formulating policies to harmonize international accounting systems.

PURPOSES OF INTERNATIONAL CLASSIFICATION

The classification process should help us describe and compare international accounting systems in a way that will promote improved understanding of the complex realities of accounting practice. The classification scheme should contribute to an improved understanding of (1) the extent to which national systems are similar to or different from each other, (2) the pattern of development of individual national systems with respect to each other and their potential for change, and (3) the reasons some national systems have a dominant influence whereas others do not. Classification should also help policymakers assess the prospects and problems of international harmonization. Policymakers at the national level will thus be in a better position to predict likely problems and identify solutions that may be feasible given knowledge of the experience of countries with similar development patterns. Developing countries seeking to choose an appropriate accounting system will also be better informed about the relevance for them of the systems used by other countries. The education of accountants and auditors who operate internationally would also be facilitated by an appropriate classification system. Similarly, such a system would promote a better understanding of and solution to problems involving the establishment of appropriate accounting and control systems for multinational enterprises (MNEs).

CLASSIFICATION OF ACCOUNTING AND REPORTING SYSTEMS

Research into the international classification of accounting systems has taken two main forms. In the deductive or judgmental approach, relevant environmental fac-

tors are identified, and, by linking these to national accounting practices, international groupings or development patterns are proposed. In the inductive or empirical approach, individual accounting practices are analyzed, development patterns or groupings are then identified, and finally explanations keyed to a variety of economic, social, political, and cultural factors are proposed.

The Deductive Approach

The environmental analysis performed by Gerhard Mueller in his book *International Accounting* (1967) provides a pioneering starting point for discussing the deductive approach to accounting classification. Mueller identified four distinct approaches to accounting development.

1. In the macroeconomic pattern, business accounting correlates closely with national economic policies. The goals of the corporation usually follow rather than lead national economic policies. Here, accounting income might be smoothed to promote economic and business stability, depreciation rates adjusted to stimulate growth, special reserves created to promote investment, and social responsibility accounting developed to meet macroeconomic concerns. Mueller gave Sweden, France, and Germany as examples of this approach.
2. In the microeconomic pattern, accounting is viewed as a branch of business economics. In this pattern, a fundamental orientation exists toward individual economic entities. Here, accounting concepts are derived from economic analysis. A fundamental concept is concerned with the maintenance in real terms of the monetary capital invested in the corporation. Replacement-value accounting as used by some companies in the Netherlands is often assumed to fit the microeconomic approach, together with developments in segmental reporting and the disclosure of employee costs, pensions, long-term commitments, and so on.
3. In the independent discipline pattern, accounting is viewed as a service function and is derived from business practice. A deep-seated respect for pragmatism and judgment exists here. Accounting is considered to be capable of developing its own conceptual framework, derived on a piecemeal basis from its own successful business practices. Income is a pragmatic measure that seems useful in practice, and full and fair disclosure is a “generally accepted accounting principle” that has evolved over the years. Mueller cited the United States and the United Kingdom as comprehensive examples of this approach.
4. In the uniform accounting pattern, accounting is viewed as an efficient means of administration and control. Here, a more scientific approach to accounting is adopted whereby a uniform approach to measurement, disclosure, and presentation will promote ease of use and a means of control for all types of businesses by all kinds of users, including managers, governments, and tax authorities. Centrally planned economies, as well as other countries with a strong government involvement in economic

planning, such as France, Germany, Sweden, and Switzerland, are given as typical examples.

Although Mueller perceived all these judgmentally assessed patterns or approaches as closely linked to economic or business factors, he recognized a wider set of influences, such as legal system, political system, and social climate, as relevant to accounting development, though without offering precise specification. Mueller gave no explicit recognition to cultural factors, which were presumably subsumed within the set of environmental factors he identified.

Mueller's further contribution to the research on classifying international accounting was his categorization of business environments, which he then linked to different types of accounting systems. Using assessments of economic development, business complexity, political and social climates, and legal systems, Mueller identified 10 country groupings. Although Mueller pointed out that different business environments need different accounting systems, he did not empirically assess accounting differences in practice.

Mueller's environmental analysis was adapted and extended by Nobes (1983), who based his hypothetical classification on an evolutionary approach to the identification of measurement practices in developed Western nations. Nobes adopted a hierarchical scheme of classification (see Figure 2.1) to lend more subtlety and discrimination to the assessment of country differences. However, like Mueller, he made no explicit mention of cultural factors. Nobes made a basic distinction between microeconomic and macroeconomic systems, and a further disaggregation between business economics and business practice orientations under the micro-based classification. Under the macro-uniform based classification, he made a disaggregation between a government/tax/legal orientation and a government/economics orientation. He then hypothesized further disaggregations between U.K. and U.S. influences under the business practices orientation and between tax-based and law-based systems under the government/tax/legal orientation. The increased discrimination permitted by this analysis, however, is balanced by the problems of allocating countries to categories—for example, to tax-based or law-based families when both aspects are influential, as with France versus Germany. Japan is also difficult to categorize given the macro-based continental European influences of taxes, as well as the micro-based U.S. influence on the securities laws.

Nobes then tested this classification system by means of a judgmental analysis of measurement and valuation reporting practices in 14 developed countries. He used a structural approach to accounting practices whereby he assessed major features such as the importance of tax rules, the use of prudent/conservative valuation procedures, and the making of replacement cost adjustments (see Exhibit 2.1). Nine factors were identified as those likely to predict which countries would be grouped together, and Nobes then scored these factors based on questionnaires and personal judgment.

His statistical analysis did indeed provide strong support for the classification of countries as either micro-based or macro-based, but it went little beyond this. Nevertheless, empirical research by Douppnik and Salter (1993) on a larger number of countries also provided broad support for Nobes's classifications. In a study of 50 countries, communist as well as capitalist, the macro/micro classification was clearly supported by both measurement and disclosure practices.

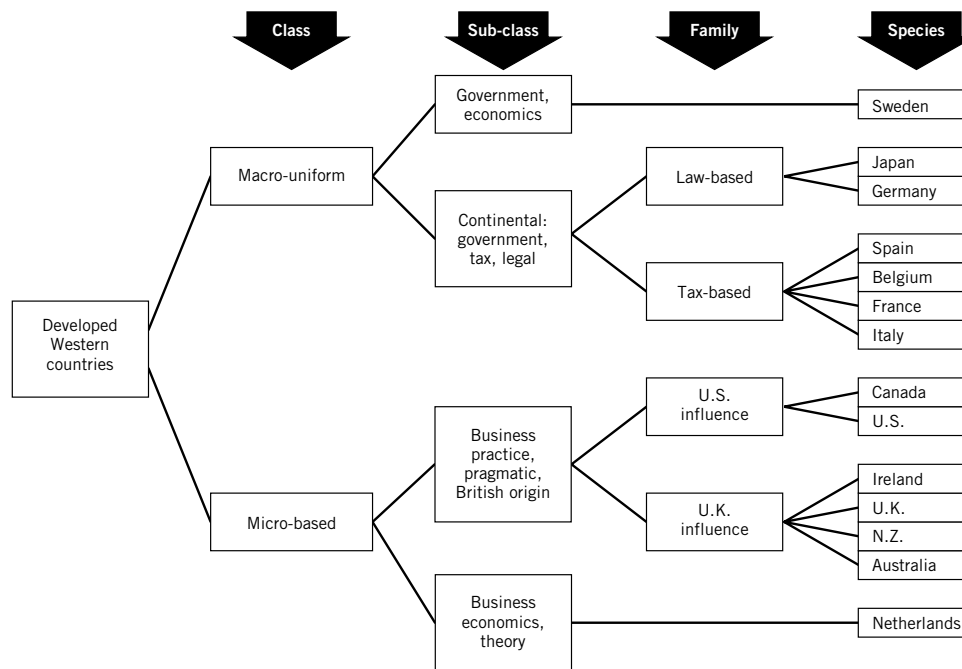


Figure 2.1 A Hypothetical Classification of Financial Reporting Measurement Practices in Developed Western Countries

More recently, Nobes (1998) has updated his classification scheme to distinguish between strong and weak equity market and shareholder orientations (see Figure 2.2). This incorporates changes that are taking place internationally whereby some companies in countries such as Germany and Japan are accounting on a basis consistent with U.S. generally accepted accounting principles (U.S. GAAP) or International Accounting Standards (IASs).

The Inductive Approach

By way of contrast to the studies discussed in the previous section, the inductive approach to identifying accounting patterns begins with an analysis of individual accounting practices. Perhaps the most important contribution of this type was by Nair and Frank (1980), who carried out a statistical analysis of international accounting practices using the Price Waterhouse surveys of 1973 and 1975. They made an empirical distinction between measurement and disclosure practices because these were considered to have different patterns of development.

The empirical results, using factor analysis applied to individual practices, showed that with respect to the Price Waterhouse (1973) data it was possible to identify four measurement groupings characterized broadly as the British Commonwealth, Latin American, continental European, and U.S. models. This result seems plausible and fits quite well with prior research on national accounting sys-

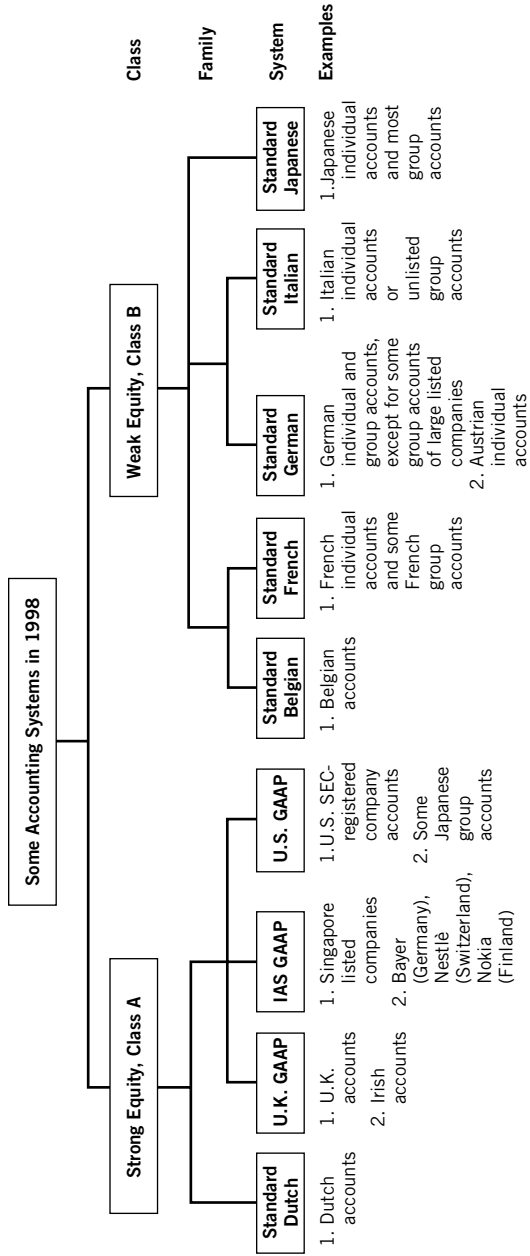


Figure 2.2 Reasons for International Differences in Financial Reporting

tems. Regarding disclosure, however, seven groupings were identified that could not be plausibly described, nor could any explanation be offered for the differences between them and the measurement groupings.

With respect to the Price Waterhouse (1975) data, it was possible to identify five measurement groupings of countries, with Chile as a single-country “group” (see Exhibit 2.1). However, the number of groupings increased to seven when disclosure practices were considered, the same number as in the results of the 1973 data analysis. The measurement groupings were characterized broadly, in this case, as the British Commonwealth, Latin American/south European, northern and central European, and U.S. models. The disclosure groupings, on the other hand, could not be similarly described, nor could any plausible description or explanation be offered.

Subsequent to the identification of country groupings, Nair and Frank attempted to assess the relationships of these groupings with a number of explanatory variables. Although relationships were established with respect to some of the variables—which included language (as a proxy for culture), various aspects of economic structure, and trading ties—it was clear that there were differences between the measurement and disclosure groupings. Moreover, the hypotheses that cultural and economic variables might be more closely associated with disclosure practices and trading variables with measurement practices were not supported.

One problem with this type of research is the lack of reliability and relevance in the data for the research problem under investigation. Problems arose in the

Exhibit 2.1 Measurement Groupings (1975 Survey)

I. British Commonwealth Model	II. Latin American/South European Model	III. Northern and Central European Model	IV. United States Model	V
Australia	Argentina	Belgium	Bermuda	Chile
Bahamas	Bolivia	Denmark	Canada	
Fiji	Brazil	France	Japan	
Iran	Colombia	Germany	Mexico	
Ireland	Ethiopia	Norway	Philippines	
Jamaica	Greece	Sweden	United States	
Malaysia	India	Switzerland	Venezuela	
Netherlands	Italy	Zaire		
New Zealand	Pakistan			
Nicaragua	Panama			
Rhodesia	Paraguay			
Singapore	Peru			
South Africa	Spain			
Trinidad	Uruguay			
United Kingdom				

Source: R. D. Nair and W. G. Frank, “The Impact of Disclosure and Measurement Practices on International Accounting Classifications,” *Accounting Review* (July 1980): 433.

Price Waterhouse surveys with respect to data errors, misleading answers, swamping of important questions by trivial ones, and exaggeration of differences between the United States and the United Kingdom. Perhaps the fundamental weakness of the surveys was that some confusion existed between the rules (mandatory and nonmandatory) and actual practices, which are often different.

From this review of some of the major studies in international classification it seems clear that research in this area is still in a relatively early stage with only very broad country groupings or accounting patterns so far identified. Furthermore, only very general relationships between environmental factors and accounting systems have been established.

Also noteworthy is the fact that in all this classification research, little explicit attention has been given to the influence of culture as a possibly more fundamental factor underlying differences in international accounting systems.

CULTURAL INFLUENCES ON ACCOUNTING SYSTEMS

In accounting, the importance of culture and its historical roots is now increasingly being recognized. Although there has been a lack of attention to this dimension in the past in the international classification literature, Harrison and McKinnon (1986) proposed a methodological framework incorporating culture for analyzing changes in corporate financial reporting regulation at the nation-specific level. The use of this framework to assess the impact of culture on the form and functioning of accounting was demonstrated through an analysis of Japan's accounting system. Culture is considered an essential element in the framework for understanding how social systems change because culture influences norms and values and group behavior within and across systems.

Complementing this approach is the proposal by Gray (1988) that a theoretical framework incorporating culture could be used to explain and predict international differences in accounting systems and to identify patterns of accounting development internationally.

Gray argued that culture, or societal values, at the national level may be expected to permeate organizational and occupational subcultures as well, though with varying degrees of integration. Accounting systems and practices can influence and reinforce societal values. With this in mind, we can perhaps obtain more fundamental insights than we hitherto have into why there are differences between national systems of accounting and reporting, both internal and external.

Figure 2.3 shows a model of the process whereby societal values influence the accounting subculture. The figure shows the influence of societal values on the institutional framework for the development of accounting, for example, the legal system, professional associations, and so on. Accordingly, the value system or attitudes of accountants are shown as being related to and derived from societal values and particularly work-related values. Accounting "values" or attitudes, for example, conservatism, will, in turn, have an impact on the development of accounting systems in the individual country. This is particularly true for measurement and disclosure practices and the approach to regulation, that is, statutory versus professional or self-regulation.

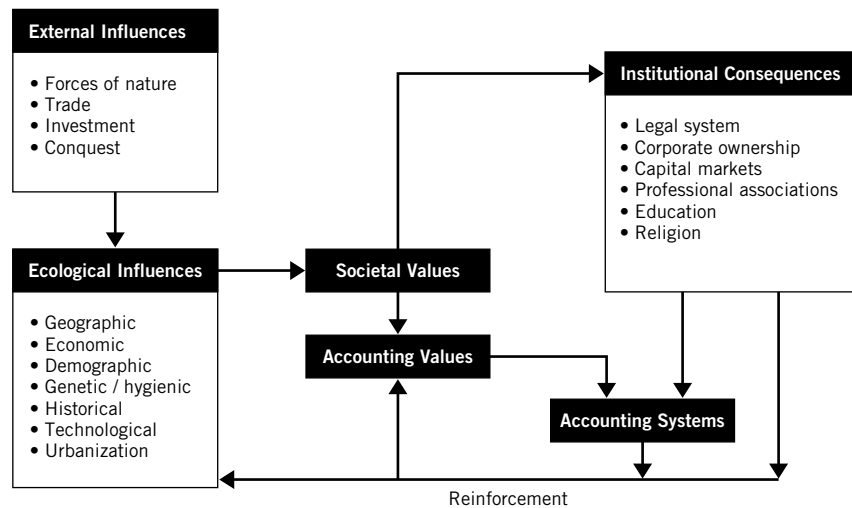


Figure 2.3 Culture, Societal Values, and the Accounting Subculture

Source: S. J. Gray, "Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally," *Abacus* (March 1988): 7.

More specifically, Gray explored the extent to which the cultural values identified by Hofstede (1980) from his cross-cultural research into work-related values could be helpful in this task.

CULTURE, SOCIETAL VALUES, AND ACCOUNTING

Structural Elements of Culture that Affect Business

Hofstede's pioneering research in the 1970s was aimed at detecting the structural elements of culture, particularly those that most strongly affect known behavior in the work situations of organizations and institutions. In perhaps one of the most extensive cross-cultural surveys ever conducted, psychologists collected data about "values" from the employees of an MNE located in more than 50 countries. Hofstede's statistical analysis and reasoning revealed four underlying societal value dimensions—that is, collective values at the national level along which countries could be positioned. These dimensions, with substantial support from prior work in the field, were labeled Individualism, Power Distance, Uncertainty Avoidance, and Masculinity. Subsequent research by Hofstede and Bond (1988) into Chinese values revealed a fifth dimension: a short-term versus long-term orientation, or what was termed Confucian Dynamism. Such dimensions, which we will discuss shortly, were perceived to represent elements of a common structure in cultural systems. It was also shown how countries could be grouped into culture areas, on the basis of their scores on the four value dimensions, using cluster analysis and taking into account geographical and historical factors. Exhibit 2.2 shows the countries within each of the identified culture areas and any identifiable subgroups of countries within each group.

Exhibit 2.2 Culture Areas

More developed Latin	Less developed Latin	More developed Asian
Belgium	Colombia	Japan
France	Ecuador	
Argentina	Mexico	
Brazil	Venezuela	
Spain	Costa Rica	
Italy	Chile	
	Guatemala	
Less developed Asian	Panama	African
Indonesia	Peru	East Africa
Pakistan	Portugal	West Africa
Thailand	Salvador	
Taiwan	Uruguay	
India	Near Eastern	Asian colonial
Malaysia	Arab countries	Hong Kong
Philippines	Greece	Singapore
	Iran	
	Turkey	
	Yugoslavia	
Germanic	Anglo	Nordic
Austria	Australia	Denmark
Israel	Canada	Finland
Germany	Ireland	Netherlands
Switzerland	New Zealand	Norway
	United Kingdom	Sweden
	United States	
	South Africa	

Source: G. Hofstede, *Culture's Consequences* (Beverly Hills: Sage, 1980), p. 336.

In a recent update, Hofstede (2001) summarizes the many studies that have replicated his research or extended it to many countries not covered by his original study. Given the limitations of any attempts to measure culture, most of these studies tend to confirm his findings, thus demonstrating the overall usefulness of his framework in giving insight into cultural values at the national or societal level. At the same time, Hofstede does recognize that cultural values are likely to change over time and that further research is required to assess the extent and reasons for change.

If societal value orientations are related to the development of accounting systems, given that such values permeate a nation's social system, then—as Gray sug-

gests—there should be a close match between culture areas and patterns of accounting systems internationally.

Furthermore, assuming that Hofstede has correctly identified Individualism, Power Distance, Uncertainty Avoidance, Masculinity, and Confucian Dynamism as significant cultural value dimensions, it can then be argued that it should be possible to establish their relationship to “accounting values.” If such a relationship exists, then a link between societal values and accounting systems can be established and the influence of culture assessed.

Before an attempt can be made to identify significant accounting values that may be related to societal values, it is important to understand the meaning of the four value dimensions initially identified by Hofstede (1984).

Individualism versus Collectivism Individualism stands for the preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only. Its opposite, collectivism, stands for the preference for a tightly knit social framework in which individuals expect their relatives, clan, or other in-group to look after them in exchange for unquestioning loyalty (the word “collectivism” is not used here to describe any particular political system). The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among individuals. It relates to people’s self-concept: “I” or “we.”

Large versus Small Power Distance Power Distance is the extent to which the members of a society accept the idea that power in institutions and organizations is distributed unequally. This affects the behavior of the less powerful as well as the more powerful members of society. People in Large Power Distance societies accept a hierarchical order in which everybody has a place that needs no further justification. People in Small Power Distance societies strive for power equalization and demand justification for power inequalities. The fundamental issue addressed by this dimension is how a society handles inequalities among people when they occur. This has obvious consequences for the way people build their institutions and organizations.

Strong versus Weak Uncertainty Avoidance Uncertainty Avoidance is the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. This feeling leads them to hold beliefs promising certainty and to maintain institutions protecting conformity. Strong Uncertainty Avoidance societies maintain rigid codes of belief and behavior and are intolerant of deviant persons and ideas. Weak Uncertainty Avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated. The fundamental issue addressed by this dimension is how a society reacts to the fact that time only runs one way and that the future is unknown, and whether it tries to control the future or just lets it happen. Like Power Distance, Uncertainty Avoidance has consequences for the way people build their institutions and organizations.

Masculinity versus Femininity Masculinity stands for the preference in society for achievement, heroism, assertiveness, and material success. Its opposite, Femininity, stands for the preference for relationships, modesty, caring for the weak, and the quality of life. The fundamental issue addressed by this dimension is the way in which a society allocates social (as opposed to biological) roles to the sexes.

The fifth dimension, labeled Confucian Dynamism, refers to a **short-term versus long-term orientation**. This dimension is described as Confucian because the values

involved seem to be identifiable with the teachings of Confucius, a legendary Chinese intellectual of the sixth century B.C. The short-term orientation emphasizes respect for tradition; respect for social and status obligations regardless of cost; social pressure to “keep up with the Joneses,” even if it means overspending; small savings levels and so little money for investment; a concern to get quick results; a concern for appearances; and a concern for truth rather than virtue. The long-term orientation, on the other hand, emphasizes the adaptation of traditions to meet modern needs; a respect for social and status obligations within limits; a thrifty and sparing approach to resources; large savings levels and funds available for investment; perseverance toward achieving gradual results; a willingness to subordinate personal interests to achieve purpose; and a concern for a virtuous approach to life.

Accounting Values

Having identified societal values, is it possible to identify significantly related accounting values at the subcultural level of the accountant and accounting practice? Gray (1988) proposed the identification of four accounting values, derived from a review of accounting literature and practice, as follows:

1. *Professionalism versus statutory control*: This value reflects a preference for the exercise of individual professional judgment and the maintenance of professional self-regulation as opposed to compliance with prescriptive legal requirements and statutory control.
2. *Uniformity versus flexibility*: This value reflects a preference for the enforcement of uniform accounting practices between companies and for the consistent use of such practices over time, as opposed to flexibility in accordance with the perceived circumstances of individual companies.
3. *Conservatism versus optimism*: This value reflects a preference for a cautious approach to measurement that enables one to cope with the uncertainty of future events as opposed to a more optimistic, laissez-faire, risk-taking approach.
4. *Secrecy versus transparency*: This value reflects a preference for confidentiality and the disclosure of information about the business only to those who are most closely involved with its management and financing as opposed to a more transparent, open, and publicly accountable approach.

What arguments are there to support these accounting value dimensions? How do they relate to societal values? What impact are they likely to have on the development of national accounting systems?

Professionalism versus Statutory Control Gray proposed this value as a significant accounting value dimension because accountants are perceived to adopt independent attitudes and to exercise their individual professional judgments, to a greater or lesser extent, throughout the world.

A major controversy in many Western countries, for example, surrounds the issue of the extent to which the accounting profession should be subject to public

regulation or statutory control or should be permitted to retain control over accounting standards as a matter of private self-regulation.

The development of professional associations has a long history, but associations are much more firmly established in the Anglo-American countries, such as the United States and the United Kingdom than in some of the continental European countries (e.g., France, Germany, and Switzerland) and in many of the less developed countries.

In the United Kingdom, for example, the concept of presenting “a true and fair view” of a company’s financial position and results depends heavily on the judgment of the accountant as an independent professional. This is so to the extent that accounting information disclosures beyond, and sometimes contrary to, what is specifically required by law may be necessary. This contrasts with the traditional position in France and Germany, where the professional accountant’s role has been concerned primarily with the implementation of relatively prescriptive and detailed legal requirements. With the implementation of the European Union (EU) directives in the 1980s, this situation was changed to the extent that there is some movement, if not convergence, toward a more statutory approach.

To what extent then can professionalism be linked to the societal values of Individualism, Power Distance, Uncertainty Avoidance, Masculinity, and Long-Term Orientation? Professionalism can perhaps be linked most closely with the individualism and uncertainty-avoidance dimensions. A preference for independent professional judgment is consistent with a preference for a loosely knit social framework where there is more emphasis on independence, a belief in individual decisions, and respect for individual endeavor. This is also consistent with weak uncertainty avoidance where practice is all-important, where there is a belief in fair play and as few rules as possible, and where a variety of professional judgments tend to be more easily tolerated. There also appears to be a link, if less strong, between professionalism and power distance in that professionalism is more likely to be accepted in a small power distance society where there is more concern for equal rights, where people at various power levels feel less threatened and more prepared to trust each other, and where there is a belief in the need to justify the imposition of laws and codes. Professionalism would also seem to be linked with masculinity and short-term orientation to the extent that this implies a concern with individual assertiveness and social status.

Uniformity versus Flexibility This is a significant accounting value dimension because attitudes about uniformity, consistency, or comparability are a fundamental feature of accounting principles worldwide. This value is open to different interpretations, ranging from a relatively strict intercompany and intertemporal uniformity, to consistency within companies over time and some concern for comparability between companies, to relative flexibility of accounting practices to suit the circumstances of individual companies.

In countries such as France and Spain, for example, a uniform accounting plan as well as the imposition of tax rules for measurement purposes have long been in operation because there has been a concern to facilitate national planning and the pursuit of macroeconomic goals. In contrast, the United Kingdom and the United States have demonstrated more concern with intertemporal consistency and some degree of intercompany comparability because of a perceived need for flexibility.

To what extent can uniformity be linked to societal value dimensions? Uniformity can perhaps be linked most closely with the uncertainty-avoidance and individualism dimensions. A preference for uniformity is consistent with preference for strong uncertainty avoidance, which leads in turn to concern for law and order and rigid codes of behavior, need for written rules and regulations, respect for conformity, and search for ultimate, absolute truths and values. This value dimension is also consistent with a preference for collectivism, as opposed to individualism, with its tightly knit social framework, belief in organization and order, and respect for group norms. There also seems to be a link, if less strong, between uniformity and power distance: uniformity is more easily facilitated in a large power distance society in that the imposition of laws and codes promoting uniformity are more likely to be accepted.

Conservatism versus Optimism This is a significant accounting value dimension because “conservatism” is arguably “the most ancient and probably the most pervasive principle of accounting valuation” (Sterling, 1967).

Conservatism or prudence in asset measurement and the reporting of profits is seen as a fundamental attitude of accountants the world over. Moreover, conservatism varies according to country, ranging from a strongly conservative approach in Japan and some continental European countries (such as France, Germany, and Switzerland) to the much less conservative, risk-taking attitudes of accountants in the United States, the United Kingdom, and, to some extent, the Netherlands.

The varying impact of conservatism on accounting measurement practices internationally has also been demonstrated empirically. Such differences appear to be reinforced by the relative development of capital markets, the differing pressures of user interests, and the influence of tax laws on accounting practice in the countries concerned.

To what extent, then, can conservatism be linked to societal value dimensions? Conservatism can perhaps be linked most closely with the uncertainty-avoidance dimension and the short-term versus long-term orientations. A preference for more conservative measures of profits and assets is consistent with strong uncertainty avoidance that stems from a concern with security and a perceived need to adopt a cautious approach to cope with the uncertainty of future events. A less conservative approach to measurement is also consistent with a short-term orientation where quick results are expected and hence a more optimistic approach is adopted relative to conserving resources and investing for long-term results. There also seems to be a link, if less strong, between high levels of individualism and masculinity, on the one hand, and weak uncertainty avoidance on the other, to the extent that an emphasis on individual achievement and performance is likely to foster a less conservative approach to measurement.

Secrecy versus Transparency This is a significant accounting value dimension that stems as much from management as it does from the accountant because of the influence of management on the quality and quantity of information disclosed to outsiders. Secrecy, or confidentiality, in business relationships is nevertheless a fundamental accounting attitude.

Secrecy also appears to be closely related to conservatism. Both values imply a cautious approach to corporate financial reporting in general, but secrecy relates

to the disclosure dimension and conservatism relates to the measurement dimension. The extent of secrecy appears to vary across countries, with lower levels of disclosure—including instances of secret reserves—evident in Japan and continental European countries such as France, Germany, and Switzerland than in the United States and United Kingdom. These differences also seem to be reinforced by the differential development of capital markets and the public ownership of shares, which often provide incentives for the voluntary disclosure of information.

To what extent then can secrecy be linked to societal value dimensions? A preference for secrecy is consistent with strong uncertainty avoidance because the latter stems from the need to restrict the disclosure of information to outsiders to avoid conflict and competition and to preserve security. A close relationship between secrecy and power distance also seems likely in that high power distance societies are likely to be characterized by the restriction of information to preserve power inequalities. Secrecy is also consistent with a preference for collectivism, as opposed to individualism, in that its concern is for the interests of those most closely involved with the firm rather than external parties. A long-term orientation also suggests a preference for secrecy that is consistent with the need to conserve resources within the firm and to ensure that funds are available for investment relative to the demands of shareholders and employees for higher payments. A significant but possibly less important link with masculinity also seems likely to the extent that societies that place more emphasis on achievement and material success will have a greater tendency to publicize such achievements and success.

A matrix showing the nature of the relationships of accounting values with societal values is shown in Exhibit 2.3.

Accounting Values and International Classification

Having related societal values to international accounting values, it is possible, as Gray argues, to make a useful distinction between the authority for accounting systems on the one hand—that is, the extent to which such systems are determined and enforced by statutory control or professional means—and the measurement and disclosure characteristics of accounting systems, on the other. In this way, accounting values can be linked to specific accounting system characteristics (see Figure 2.4).

The accounting values most relevant to the professional or statutory authority for accounting systems as well as their enforcement appear to be professionalism and uniformity. Both are concerned with regulation and the degree of enforcement or conformity. Accordingly, these can be combined and the classification of culture areas hypothesized on a judgmental basis, as shown in Figure 2.5. In making these judgments, we will refer to the relevant correlations between value dimensions and the clusters of countries identified from the statistical analyses carried out by Hofstede. From this classification it seems clear that the Anglo and Nordic culture areas can be contrasted with the Germanic and more developed Latin culture areas as well as the Japanese, Near Eastern, less developed Latin, less developed Asian, and African culture areas. The former colonial Asian countries are separately classified because they represent a mixture of influences.

The accounting values most relevant to the measurement practices used and the extent of information disclosed are the conservatism and secrecy dimensions,

Exhibit 2.3 Matrix of Relationship of Accounting Values with Societal Values

Basic Value System	Accounting Values									
	Professionalism	Statutory Control	Uniformity	Flexibility	Conservatism	Optimism	Secrecy	Transparency		
Individualism	Positive	Negative	Negative	Positive	Negative	Positive	Negative	Positive		
Collectivism	Negative	Positive	Positive	Negative	Positive	Negative	Positive	Negative		
Large Power Distance	Negative	Positive	Positive	Negative	n/a	n/a	Positive	Negative		
Small Power Distance	Positive	Negative	Negative	Positive	n/a	n/a	Negative	Positive		
Strong Uncertainty Avoidance	Negative	Positive	Positive	Negative	Positive	Negative	Positive	Negative		
Weak Uncertainty Avoidance	Positive	Negative	Negative	Positive	Negative	Positive	Negative	Positive		
Masculinity	Positive	n/a	n/a	n/a	Negative	Positive	Negative	Positive		
Femininity	Negative	n/a	n/a	n/a	Positive	Negative	Positive	Negative		
Short term	Positive	Negative	n/a	n/a	Negative	Positive	Negative	Positive		
Long term	Negative	Positive	n/a	n/a	Positive	Negative	Positive	Negative		

Note: n/a = not applicable.

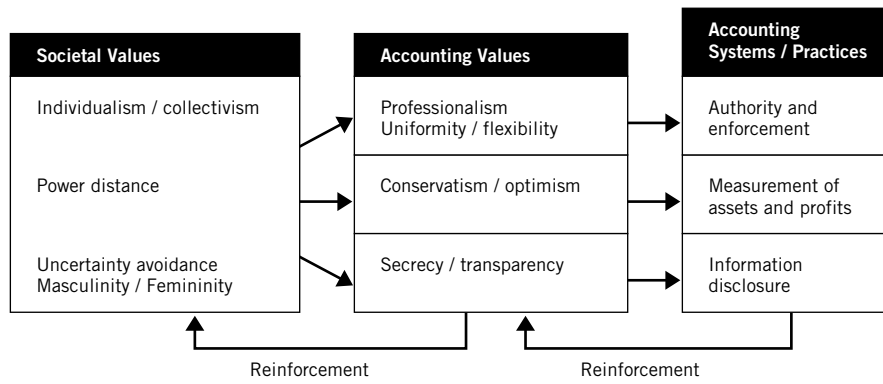


Figure 2.4 Culture and Accounting Systems in Practice

respectively. These can therefore be combined and the classification of culture areas hypothesized on a judgmental basis, as shown in Figure 2.6. As before, in making judgments about these classifications, we have again referred to the relevant correlations between value dimensions and the resultant clusters of countries identified from the statistical analysis carried out by Hofstede. Here again, there appears to be a sharp division of culture area groupings with the former

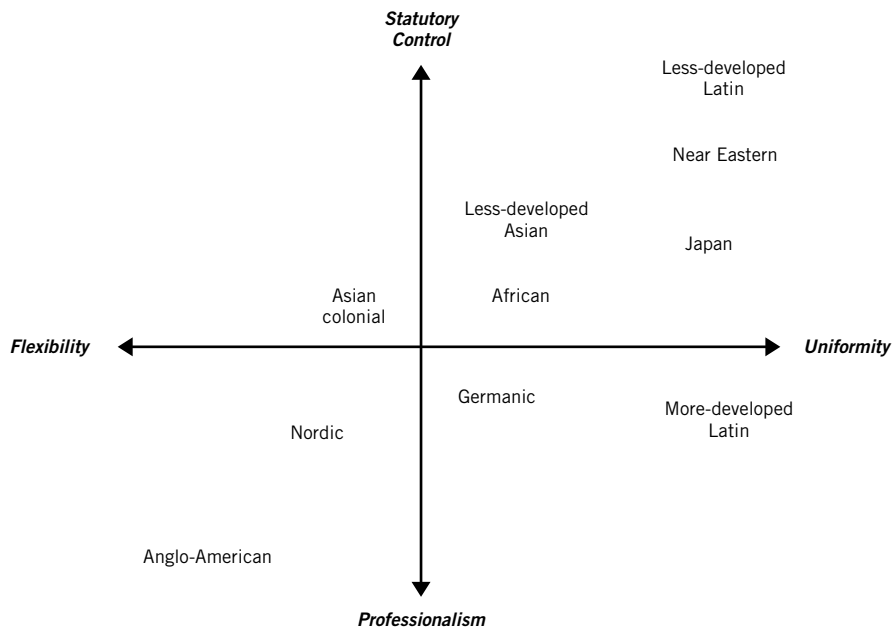


Figure 2.5 Accounting Systems: Authority and Enforcement

Source: S.J. Gray, "Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally," *Abacus* (March 1988): 12.

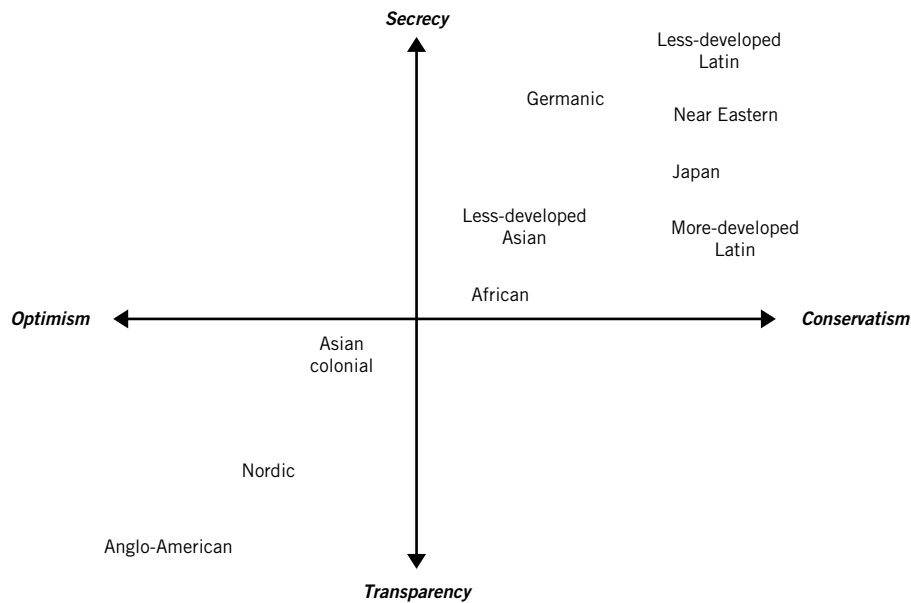


Figure 2.6 Accounting Systems: Measurement and Disclosure

Source: S. J. Gray, "Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally," *Abacus* (March 1988): 13.

Asian colonial group relating more closely with the Anglo and Nordic groupings. This can be contrasted with the Germanic and more developed Latin groupings, which are related to the Japanese, less developed Asian, African, less developed Latin, and Near Eastern-area groupings. In broad terms, countries can be grouped as either relatively optimistic and transparent or relatively conservative and secretive.

This classification of country groupings by culture area can be used as a basis for further assessing the relationship between culture and accounting systems. This classification is particularly relevant for understanding systems authority and enforcement characteristics, on the one hand, and measurement and disclosure characteristics, on the other.

In the wake of Gray's analysis, further research is needed to test the extent to which culture influences the development of international accounting practices and whether the hypothesized country groupings can be empirically supported. The research findings to date do tend to support the significance of culture as an influential factor in the development of accounting. Salter and Niswander (1995, p. 390) concluded from an empirical study of 29 countries that Gray's model "provided a workable theory to explain cross-national differences in accounting structure and practice which is particularly strong in explaining different financial reporting practices." To explain professional and regulatory structures, however, Salter and Niswander suggested that the inclusion of variables such as the development of financial markets and levels of taxation enhances the explanatory power of the model.

With respect to the conservatism dimension, empirical studies of profit measurement practices in France, Germany, the Netherlands, Sweden, the United Kingdom, and the United States indicate the existence of significant differences that support the importance of this dimension internationally. These findings are elaborated in Chapter 5.

The significance of the secrecy/transparency dimension has also received some support from recent research findings on information disclosure practices in some major countries, including Canada, France, Germany, Japan, the Netherlands, Switzerland, the United Kingdom, and the United States (see Chapter 6 for more information).

In a recent critical review of tests of Gray's theory of cultural relevance, Douplik and Tsakumis (2005) argue that substantial opportunities for research continue to exist as many of the relationships proposed in Gray's framework have yet to be adequately tested. Furthermore, they suggest that alternatives to Hofstede's dimensions might be explored such as those developed more recently by Schwartz (1994), which are based arguably on more generalizable samples, with a view to exploring the links between accounting and culture further. A greater use of the experimental method is also proposed as a way to more closely investigate the cause/effect relationship between culture and the accountant's application of financial reporting rules.

INTERNATIONAL PRESSURES FOR ACCOUNTING CHANGE

It is also important to appreciate the potential impact of forces for change that arise from international factors. Accordingly, the model developed by Gray (1988) to elaborate the process of accounting change is shown in Figure 2.7, which identifies a number of important international pressures affecting accounting change, including growing international economic/political interdependence, new trends in foreign direct investments (FDI), changes in multinational corporate strategy, the impact of new technology, the rapid growth of international financial markets, the expansion in business services, and the activities of international regulatory organizations.

Let us consider briefly some of the pressures for change that arise from growing international interdependencies and from concerns to harmonize the regulatory framework of international economic and financial relationships. Although basic distinctions have been made and may to some extent still be made between East and West (i.e., socialist countries and Western capitalist countries) and North and South (i.e., developed and developing countries), dramatic changes are occurring at the political level, which in turn are causing economic changes that are restructuring the landscape of international business and accounting. Most notably, the hitherto centrally planned economies of the former Soviet Union and Eastern Europe are embracing a more Western market-oriented approach to economic development, as is the People's Republic of China. Furthermore, the growing worldwide trend toward the deregulation of markets and the privatization of public sector corporations in many developing as well as developed countries has opened up new opportunities for international investment and international joint ventures and alliances.

Economic groupings, such as the EU, have been a major influence in promoting economic integration through the free movement of goods, people, and

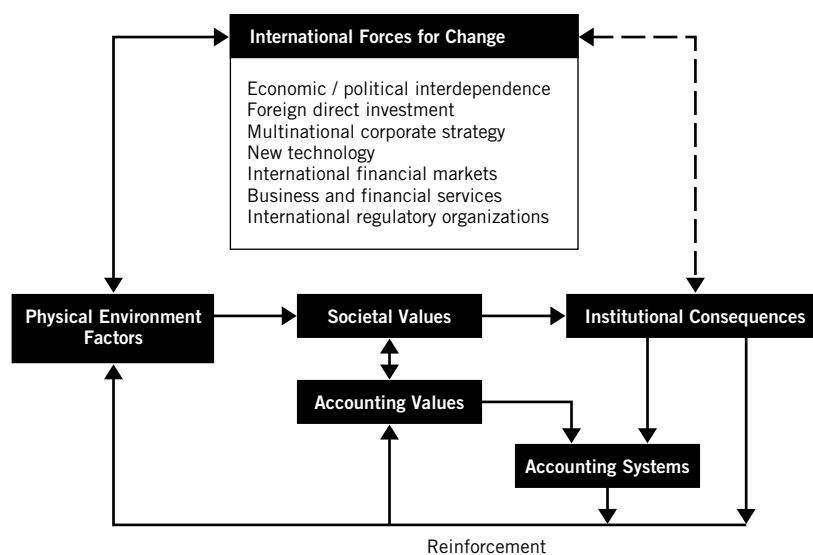


Figure 2.7 Change and Development of Accounting Values and Systems Internationally

Source: S. J. Gray, "International Accounting Research: The Global Challenge," *International Journal of Accounting* 23, no. 4 (Winter 1989): 294.

capital between countries. To achieve its goals, the EU has embarked on a major program of harmonization, including measures to coordinate the company law, accounting, taxation, capital market, and monetary systems in the EU countries. While the goal of removing all nontariff barriers has proved elusive, the EU has emerged as a major economic and, to some extent, political force in recent years. In addition, the EU is committed to helping the process of economic integration on a broader European-wide scale following the events and reforms that have taken place in Eastern Europe.

International organizations, such as the United Nations (UN) and the Organization for Economic Cooperation and Development (OECD), are also deeply involved in the development of international business on a global scale. The UN is responsible for the emergence of organizations such as the World Bank, the International Monetary Fund (IMF), the UN Conference on Trade and Development (UNCTAD), and the World Trade Organization (WTO). UNCTAD includes the work of the former Commission on Transnational Corporations, which was designed to promote an effective international framework for the operations of transnational corporations and to monitor the nature and effects of their activities. In particular, the UNCTAD and its Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been involved, among other things, in initiatives to develop international standards of accounting and reporting and to promote accounting education in Russia and Africa.

The OECD, in contrast to the UN, is focused mainly on the development of the industrialized countries of the world. The major objectives of the OECD are to

foster international economic and social development, and to this end a Code of Conduct, including information disclosure guidelines, has been issued relating to the operations of multinationals in order to encourage them to develop positive relationships with host countries.

Although the relationships between MNEs and host countries have become less antagonistic and more pragmatic and businesslike in recent years, a number of areas of continuing concern remain. There is little doubt that MNEs exert a significant impact on the culture and social development of host countries. Employment and consumption patterns are often significantly influenced by MNEs. As a result, there is pressure for more accountability to employees and consumers and for some consultation with the parties affected by the decisions of MNEs.

The environmental impact of MNEs is also an area of major and growing importance in terms of accountability. Whereas developed countries have a growing array of regulations, developing countries tend to have lower standards and are more concerned with improving economic conditions. At the same time, many MNEs have increased their awareness of pollution, safety procedures, and the need for stronger community relations. In this context, both the UN and OECD have been concerned with providing guidelines to MNEs, including the disclosure of relevant information, to encourage positive relationships with host countries.

At the level of international financial markets, there has been an interest in harmonizing differences in tax regimes, exchange controls, restrictions on foreign investments, and accounting and disclosure requirements, which still provide obstacles to the globalization of securities markets. The OECD and especially the EU have been influential in efforts to harmonize the minimum requirements for the admission of securities to the listing and content of prospectuses. In addition, the International Co-ordinating Committee of Financial Analysts Societies and the International Organization of Securities Commissions (IOSCO), both private organizations, are seeking to promote the internationalization and integration of securities markets on a global basis.

As to the internationalization of accounting and auditing standards, the International Accounting Standards Board (IASB) and the International Federation of Accountants (IFAC) are both involved in the harmonization effort and provide a professional counterpoint to the activities of intergovernmental organizations such as the UN, OECD, and the EU.

The brief discussion of some of the international pressures for change highlights the dynamic nature of accounting and accountability globally. National cultures, traditions, and practices will be increasingly challenged in the years ahead as the pressures for global convergence increasingly impact accountants and accounting practices.

SUMMARY

1. Patterns of international accounting development can be identified using a classification scheme to assess similarities and differences.
2. International accounting classification helps to describe and compare accounting systems in a way that will promote improved understanding of the nature and problems of accounting practice.

3. International classification research has been both deductive, whereby relevant environmental factors are identified and linked to accounting practices, and inductive, whereby accounting practices are analyzed and development patterns identified.

4. Although international classification research is still at a relatively early stage, it is possible to identify some broad country groupings and patterns of accounting development. At the very least, a macro/micro or strong/weak equity market pattern can be observed. Within that framework, U.S., U.K., and continental European models can be identified.

5. Cultural influences on accounting development are now increasingly being recognized. Their importance in explaining fundamental accounting differences internationally seems clear, and some support has been received from recent empirical research.

6. It is possible to identify key accounting values derived from societal cultural influences: professionalism, uniformity, conservatism, and secrecy. An international classification of accounting systems can be made on the basis of the link between accounting values, on the one hand, and accounting system characteristics, on the other.

7. The accounting values of professionalism and uniformity are linked to the authority and enforcement characteristics of accounting systems.

8. The value of conservatism is linked to the measurement of assets and profits, while secrecy is linked to the nature and extent of information disclosure or transparency.

9. A comparative analysis of accounting systems reveals not only distinctive patterns of accounting but also unique features that are applicable to each country, depending on history and culture.

10. Major international forces for accounting change are at work in the global environment, including a growing international economic/political interdependence, new trends in FDI, changes in multinational corporate strategy, the impact of new technology, the rapid growth of international financial markets, the expansion in business services, and the activities of international regulatory organizations.

Discussion Questions

1. Why is the classification of accounting systems likely to be useful?
2. What would be an example of a “deductive approach” to classifying a country’s accounting system?
3. What would be an example of an inductive approach to classifying a country’s accounting system?
4. To what extent is the strong/weak equity market distinction a useful way to identify different patterns of accounting development?
5. Are cultural influences likely to have a larger impact on accounting measurement or disclosure practices?
6. To what extent do you think culture explains the relative importance of stock exchanges and professional accounting associations around the world?
7. Where does your country fit in terms of professionalism/statutory control and uniformity/flexibility?

8. Compare your country with a country that has a different professionalism and uniformity profile.
9. Where does your country fit in terms of conservatism/optimism and secrecy/transparency?
10. Compare your country with a country that has a different conservatism and secrecy profile.
11. To what extent are countries changing with respect to national cultures and accounting values? Are they converging or diverging?
12. How important a constraint on change are national cultural differences likely to be? Are cultures themselves changing? In what way?
13. What other factors are likely to be important constraints on accounting change?
14. Which countries have the greatest potential for accounting change? What are your reasons for thinking this?
15. What international pressures for change in accounting do you think are going to be most important during the early years of the twenty-first century?

Exercises

1. Form into small groups and have each group select two countries from different culture areas (as defined by Hofstede). Identify and compare each country's societal and accounting values.
2. Locate each country in Gray's Authority and Enforcement and Measurement and Disclosure frameworks. How do the countries compare? Comment on the relevance and reliability of your findings.
3. List six cultural traits that you think have impacted the accounting system in the United States and your country.
 - a. Independence
 - b. Competition
 - c. Excellence
 - d. Quality vs. Quantity
 - e. Progress
 - f. Short-term Relationships
4. Give an example of professionalism vs. statutory control within your country. How does this example relate to the five societal values? Give concrete examples.
5. Give an example of uniformity vs. flexibility within your country. How does this example relate to the five societal values? Give concrete examples.
6. Give an example of conservatism vs. optimism within your country. How does this example relate to the five societal values? Give concrete examples.
7. Give an example of secrecy vs. transparency within your country. How does this example relate to the five societal values? Give concrete examples.
8. Consider Parmalat's accounting problems in 2003. What societal values and accounting values most contributed to Parmalat's falsified statements?
9. Consider Enron's accounting problems. What societal values and accounting values most contributed to Enron's collapse?

10. Because of the accounting scandals of the early twenty-first century, new laws like Sarbanes-Oxley have been enacted. What societal and accounting values do the laws attempt to change?
11. How has globalization impacted the viability of cultural accounting analysis? In other words, has globalization increased the common development of accounting values and decreased the importance of national societal values?
12. Using the accounting and societal values discussed in the chapter, construct a basic ideal accounting system. Is there a country that uses your system? Is there a country that closely approximates your system?
13. The chapter discusses how cultural and governmental influences impact accounting and financial reporting standards. Do accounting and financial reporting standards influence governmental or cultural standards? Consider Argentina and Russia. Support your answer.
14. Discuss the benefits and difficulties experienced by both a MNE and a host country when the MNE enters the country.
15. How have the social values, accounting values, and accounting system traits in the United States been impacted by recent globalization? What is a good measure of a country's accounting system inertia (the amount that a country's accounting system affects more than is affected by globalization of accounting systems and standards)?

Case: General Motors and Japanese Convergence vs. Chinese Convergence

Case: Inductive Methods and Deductive Methods Relating Reporting Standards to Cultural Values

These cases can be found on the following website: www.wiley.com/college/radebaugh

Selected References

- Baydoun, N., and R. Willett. 1995. "Cultural Relevance of Western Accounting Systems to Developing Countries." *Abacus* (March): 67–92.
- Chanchani, S., and R. Willett. 2004. "An Empirical Assessment of Gray's Accounting Value Constructs." *International Journal of Accounting* 39(2): 15–24.
- Choi, Frederick D. S. 1974. "European Disclosure: The Competitive Disclosure Hypothesis." *Journal of International Business Studies* (Fall): 15–24.
- Doupnik, T. S., and S. B. Salter. 1993. "An Empirical Test of a Judgmental International Classification of Financial Reporting Practices." *Journal of International Business Studies* (first quarter): 41–60.
- Doupnik, T. S., and S. B. Salter. 1995. "External Environment, Culture, and Accounting Practice: A Preliminary Test of a General Model of International Accounting Development." *International Journal of Accounting* 30(3): 189–207.
- Doupnik, Timothy S., and George T. Tsakumis. 2005. "A Critical Review of Tests of Gray's Theory of Cultural Relevance and Suggestions for Future Research." *Journal of Accounting Literature*, forthcoming.
- Gray, S. J. 1980. "The Impact of International Accounting Differences from a Security Analysis Perspective: Some European Evidence." *Journal of Accounting Research* (Spring): 64–76.
- Gray, S. J. 1985. "Cultural Influences and the International Classification of Accounting Systems." Paper presented at the European Institute for Advanced Studies in Management Workshop on "Accounting and Culture," Amsterdam (June).
- Gray, S. J. 1988. "Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally." *Abacus* (March): 1–15.

- Gray, S. J. 1989. "International Accounting Research: The Global Challenge." *International Journal of Accounting* 23(4): 291–307.
- Gray, S. J., and H. M. Vint. 1995. "The Impact of Culture on Accounting Disclosures: Some International Evidence." *Asia-Pacific Journal of Accounting* 2: 33–43.
- Harrison, G. L., and J. L. McKinnon. 1986. "Culture and Accounting Change: A New Perspective on Corporate Reporting Regulation and Accounting Policy Formulation." *Accounting, Organisations and Society* 11(3): 233–252.
- Hofstede, Geert. 1980. *Culture's Consequences: International Differences in Work-Related Values*. Beverly Hills, CA: Sage.
- Hofstede, Geert. 1984. "Cultural Dimensions in Management and Planning." *Asia Pacific Journal of Management* (January): 81–90.
- Hofstede, Geert. 1991. *Cultures and Organizations*. Maidenhead, England: McGraw-Hill.
- Hofstede, Geert. 2001. *Culture's Consequences: Comparing Values, Behaviours, Institutions and Organizations Across Nations*. 2nd ed. Thousand Oaks, CA: Sage.
- Hofstede, Geert, and Michael H. Bond. 1988. "The Confucius Connection: From Cultural Roots to Economic Growth." *Organizational Dynamics* 16(4): 5–21.
- International Accounting Standards Board. www.iasb.org.uk.
- International Association for Accounting Education and Research. www.iaaer.org.
- Jaggi, B. C. 1973. "The Impact of the Cultural Environment on Financial Disclosures." *International Journal of Accounting* (Spring): 75–84.
- McKinnon, J. L. 1986. *The Historical Development and Operational Form of Corporate Reporting Regulation in Japan*. New York: Garland.
- Mueller, Gerhard G. 1967. *International Accounting*. New York: Macmillan.
- Mueller, Gerhard G. 1968. "Accounting Principles Generally Accepted in the U.S. versus Those Generally Accepted Elsewhere." *International Journal of Accounting* (Spring).
- Nair, R. D., and Werner G. Frank. 1980. "The Impact of Disclosure and Measurement Practices on International Accounting Classifications." *Accounting Review* (July): 426–451.
- Nobes, C. W. 1983. "A Judgmental International Classification of Financial Reporting Practices." *Journal of Business Finance and Accounting* (Spring): 1–19.
- Nobes, C. W. 1984. *International Classification of Financial Reporting*. London: Croom Helm.
- Nobes, C. W. 1998. "Towards a General Model of the Reasons for International Differences in Financial Reporting." *Abacus* (September): 162–187.
- Nobes, C. W., and R. H. Parker, eds. 2000. *Comparative International Accounting*. 6th ed. Englewood Cliffs, NJ: Prentice-Hall.
- Parker, R. H. 1989. "Importing and Exporting Accounting: The British Experience." In *International Pressures for Accounting Change*, edited by A. G. Hopwood. Englewood Cliffs, NJ: Prentice-Hall: 7–29.
- Perera, H. 1994. "Culture and International Accounting: Some Thoughts on Research Issues and Prospects." *Advances in International Accounting* 7: 267–285.
- Pourjalali, G., and G. K. Meek. 1995. "Accounting and Culture: The Case of Iran." *Research in Accounting in Emerging Economies* 3: 3–17.
- Salter, Stephen, and Frederick Niswander. 1995. "Cultural Influence on the Development of Accounting Systems Internationally: A Test of Gray's (1988) Theory." *Journal of International Business Studies* 26(2): 379–397.
- Saudagaran, Shahrokh, and Gary Biddle. 1992. "Financial Disclosure Levels and Foreign Stock Exchange Listing Decisions." *Journal of International Financial Management and Accounting* (Summer): 106–148.
- Schwartz, S. H. 1994. *Individualism and Collectivism: Theory, Method and Applications*. Thousand Oaks, CA: Sage.
- Sterling, Robert R. 1967. "Conservatism: The Fundamental Principle of Valuation in Traditional Accounting." *Abacus* (December): 109–132.
- United Nations. 1977. *International Standards of Accounting and Reporting*. New York: UN.

- United Nations. 1988. *Conclusions on Accounting and Reporting by Transnational Corporations*. New York: UN, revised.
- Weetman, P., and S. J. Gray. 1990. "International Financial Analysis and Comparative Corporate Performance: The Impact of U.K. versus U.S. Accounting Principles on Earnings." *Journal of International Financial Management and Accounting* (Summer/Autumn): 111–130.
- Weetman, P., and S. J. Gray. 1991. "A Comparative Analysis of the Impact of Accounting Principles on Profits: The U.S.A. versus the U.K., Sweden, and the Netherlands." *Accounting and Business Research* (Autumn): 363–379.
- Zeff, S. A. 1972. *Forging Accounting Principles in Five Countries*. New York: Stipes.