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# Does Culture Still Influence Accounting Judgments Post IFRS? A Discussion and Proposal for Research

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## **ABSTRACT**

The paper considers how culture may influence the financial accounting judgments made by firms post convergence to International Financial Reporting Standards (IFRS). The cultural framework established by Hofstede (1980) and accounting values developed by Gray (1988) will provide the theoretical framework in the proposed examination of differences in culture and accounting values between Anglo and Latin American nations. This proposed research provides a framework towards the understanding and prediction of the role and influence of culture in contemporary international accounting and financial reporting as well as need to address culture if IFRS is to be successful.

## **Keywords**

Culture, accounting, property, plant, and equipment, intangible assets, research and development, development, International Financial Reporting Standards (IFRS).

## **1. INTRODUCTION**

The number of countries that require or allow the use of International Financial Reporting Standards (IFRS) developed by the International Accounting Standards Board (IASB) continues to grow and many other countries plan to adopt or converge to IFRS in the near future. The primary goal of IFRS is to provide a set of global accounting standards in which the comparability and consistency of the financial reporting between companies throughout the world will be harmonized. One of the key changes for countries adopting IFRS is the ability to have choice in the accounting policy to measure property, plant, and equipment (International Accounting Standard (IAS 16)), intangible assets (IAS 38), investment properties held (IAS 40), and research and development costs (IAS 38). Upon adoption of IFRS, firms can either value assets using the cost or what is referred to as the revaluation model. The revaluation model permits the continual valuation of assets at fair market value in addition to a one-time option to revalue these assets. IFRS also permits the capitalization of certain research and development costs as opposed to their expensing per IAS 38.

Culture can be considered a significant factor in the accounting practices of a country. Violet (1983) argues that accounting is determined by culture. Violet (1983) also claimed that the success of international accounting standards would be impeded by cultural differences. Hofstede (1987) claims that the

inconsistency in accounting between countries is the result of culture rather than technical issues. This paper considers that culture will influence the decisions made in the selection of accounting methods for property, plant and equipment (PPE), investment assets, intangible assets, and research and development. This proposed research will attempt to examine the theories developed by Hofstede (1980) and Gray (1988) in the study of the relevance of culture on accounting values. This research proposal will attempt to provide a better understanding and prediction of the role and influence of culture in contemporary international accounting and financial reporting. In addition, this research will provide insight of the need to address culture if IFRS is to be successful in its goal to provide comparable and consistent accounting between firms located throughout the world.

## **2. HOFSTEDE'S CULTURAL FRAMEWORK AND GRAY'S MODEL**

Culture can have a significant influence on the accounting practices of a country. Hofstede's (1980) research on culture represents the most extensive research on national culture. Hofstede (1980) defines culture as the "collective programming of the mind which distinguishes the members of one human group from another". Hofstede (1980) performed attitude surveys on more than 116,000 individuals from 67 different countries and found that the differences between individuals were due to individual's country of origin rather than level of education, gender, age, position held with the company, etc. Hofstede's study provides quantitative measures of cultural dimensions for each country in the study. Hofstede identified four cultural dimensions with positioning of over 40 countries/geographic areas. These four dimensions developed by Hofstede (1980) were:

1. *Individualism versus Collectivism*: Individualism is the preference of individuals to stress care for themselves or their immediate family members. Collectivism refers to individuals working as a cohesive group or organization. These preferences relate to the self concept of "I versus we".
2. *Power distance (Large versus small)*: the extent to which members of a society accept that power in institutions is distributed equally. Large power distance societies accept a hierarchical order that needs no justification. Small power distance societies strive

for power equalization and demand justification for power inequalities.

3. *Uncertainty avoidance (Strong versus weak)*: the degree to which members of a society are uncomfortable with uncertainty and ambiguity.
4. *Masculinity versus Femininity*: Masculinity refers to the preference in a society for achievement, heroism, assertiveness, and success. Femininity is the preference for relationships, modesty, and the quality of life.

Gray (1988) is well known in the research of accounting through his development of the theory of how culture can impact on the accounting values of a country. Gray (1988) developed a theoretical framework and a set of hypotheses that linked accounting attitudes based on the cross cultural work of Hofstede (1980). Gray (1988) extends Hofstede's (1980) framework by providing a model that overlay the accounting values and systems to the societal values and norms of each country.

The four dimensions of "accounting values" developed by Gray (1988) are as follows:

1. *Professionalism versus statutory control*-the preference for the exercise of individual judgment as opposed to legal requirements and statutory control. Gray hypothesized that the higher that a country ranks in terms of individualism and the lower it ranks in uncertainty avoidance and power distance, then the higher it is to rank highly in terms of professionalism.
2. *Uniformity versus flexibility*- the preference for enforcement of uniform accounting practices between companies and in the use of these consistent practices as opposed to flexibility in the use of these principles. The higher a country ranks in terms of uncertainty avoidance and power distance and the lower it ranks in terms of individualism then the more likely it is to rank highly in terms of uniformity.
3. *Conservatism versus optimism*- the preference for a cautious approach as opposed to a more risk taking, optimistic approach. The higher a country ranks in terms of uncertainty avoidance and the lower in terms of individualism and masculinity then the more likely it is to rank highly in terms of conservatism.
4. *Secrecy versus transparency*- the preference for confidentiality and restriction of disclosure of information as opposed to the more transparent and open approach. The higher a country ranks in terms of uncertainty avoidance and power distance and the lower it ranks in terms of individualism and masculinity then the more likely it is to rank in terms of secrecy.

The following are Gray's hypotheses:

1. *Hypothesis 1*: the higher a country ranks in terms of individualism, the lower it ranks in terms of uncertainty avoidance and power distance and the more likely it is to rank highly in terms of professionalism.

2. *Hypothesis 2*: the higher the country ranks in terms of uncertainty avoidance and power distance and the lower it ranks in terms of individualism then the more likely it will rank in uniformity.
3. *Hypothesis 3*: the higher a country ranks in terms of uncertainty avoidance and the lower it ranks in terms of individualism and masculinity then the more likely it is to rank highly in terms of conservatism.
4. *Hypothesis 4*: The higher the country ranks in terms of uncertainty avoidance and power distance and the lower it ranks in terms of individualism and masculinity then the more likely it is to rank highly in terms of secrecy.

Gray (1988) suggests that accounting values most relevant to measurement practices used and to the extent of disclosure are strongly linked to the conservatism and secrecy dimensions. Gray (1988) hypothesized that the most important societal values developed by Hofstede (1980) on the accounting values of a culture were uncertainty avoidance and individualism. Lesser important societal values impacting accounting values were the dimensions of power distance and masculinity. It should be noted that Gray (1988) did not empirically test his hypotheses of how these cultural characteristics are related to these proposed accounting values.

As Gray (1988) predicts measurement practices and the extent of disclosure being strongly linked to conservatism/optimism and secrecy/transparency, these two dimensions may be combined in order to classify the clusters of countries that were formulated by Hofstede (1980).

### **3. LITERATURE TESTING HOFSTEDE (1980) CULTURAL DIMENSIONS TO GRAY'S (1988) ACCOUNTING VALUES OF CONSERVATISM AND SECRECY**

As this research proposal relates to accounting judgments in the valuation of assets, the literature review testing the theoretical framework of Hofstede (1980) and Gray (1988) will focus on the accounting practices of measurement and information disclosure. Gray's (1988) Hypothesis #3 and #4 will therefore be the focus of the literature review as well as the proposal for future research. As such, the relationships between the cultural values of individualism, power distance, uncertainty avoidance, and masculinity and their influence of the accounting values of conservatism and secrecy will be the focus of this research proposal.

Eddie (1990) was first to empirically study the influence of culture on accounting values. Eddie (1990) finds evidence to support all four of Gray's (1988) hypotheses in his study of thirteen Asian-Pacific countries. However, Eddie's (1990) use of accounting value constructs were not rigorous and had no independent validation as the dependent variable utilized were scores calculated by the author from unidentified data sources. Therefore the study can be considered weak.

There have been several studies testing Gray's (1988) Hypotheses #3 in the relationship of the accounting values of conservatism/optimism to the cultural values of individualism, uncertainty avoidance, and masculinity. Salter and Niswander (1995) utilize data from 29 countries and find significant correlations between 6 of 13 relationships that Gray (1988) hypothesized, suggesting that some aspects of Gray's theory was invalid. Salter and Niswander (1995) find significant explanatory power in finding that conservatism is positively related to uncertainty avoidance and negatively related to masculinity. Doupnik and Richter (2004), Doupnik and Riccio (2006), and Schultz and Lopez (2001) all find that that conservatism is positively correlated to uncertainty avoidance and negatively correlated to masculinity. Tsakumis (2007) does not find support of Gray's hypothesis of conservatism relating to uncertainty avoidance, individualism, and masculinity in his study that finds that Greek accountants are more conservative than US accountants. Based on review of the literature, this research proposal expects the following relationships in regard to conservatism:

Country	Cluster	UA	IND	MA	Gray hypothesis result
LA	High	Low	Low	=	High on Conservatism
Anglo	Low	High	High	=	Low on Conservatism

Abbreviations:

LA Latin America    UA Uncertainty Avoidance  
 IND Individualism    MA Masculinity

There have been several studies testing Gray's (1988) hypothesis # 4 in the relationship of the accounting value of secrecy/transparency to the cultural values of individualism, power distance, uncertainty avoidance, and masculinity. Jaggi (1975) was first to examine the impact of culture on the extent of financial disclosures. Salter and Niswander (1995) find significant evidence in finding that secrecy to be positively related to uncertainty avoidance and negatively related to masculinity. Gray and Vint (1995) studied 27 countries and found correlations that supported all of Gray's (1988) hypotheses in regard to secrecy. Zareski (1996) studied 7 countries and finds support for secrecy related to individualism, uncertainty avoidance, and masculinity. However Zareski's (1996) study finds that power distance is significant but in the opposite direction that Gray (1988) predicts. Doupnik and Riccio (2006) study Brazilian and US accountants and find that Brazilian accountants are least likely to provide disclosure of an item as opposed to US accountants. Jaggi and Low (2000) find support for Gray's hypothesis on individualism and secrecy. Wingate (1997) studied 39 countries and finds support of Gray's hypothesis relating individualism and uncertainty avoidance. Hope (2003) studied 39 countries and finds support for Gray's (1988) hypothesis relating individualism and uncertainty avoidance; provided individualism and uncertainty avoidance are included in the model. Hope (2003) finds masculinity to be strongly negatively correlated to secrecy, however does not find significant correlations of power distance and uncertainty avoidance in relation to secrecy. Tsakumis (2007) finds that Greek accountants are less likely to disclose both contingent

assets and liabilities as opposed to US accountants. Based on the review of the literature, this research proposal expects the following relationships in regard to secrecy:

Country	Cluster	UA	PD	IND	Gray hypothesis result
LA	High	High	Low	=	High on Secrecy
Anglo	Low	Low	High	=	Low on Secrecy

Abbreviations:

LA Latin America    UA Uncertainty Avoidance  
 PD Power Distance    IND Individualism

**4. PROPOSAL FOR RESEARCH**

This research proposes the use of cultural values of Latin American and Anglo countries that have been quantitatively developed by Hofstede (1980) as independent variables. The accounting values of conservatism/optimism and secrecy/transparency will be the research's dependent variables. These dependent variables will be measured by the frequency and magnitude of the firm's revaluations of the property, plant, and equipment, intangible assets, and the capitalization versus expensing of research and development costs in conjunction with the breadth of disclosures relating to their accounting treatment. The purpose of this research proposal is to gain a better understanding of the role and influence of culture in contemporary international accounting and financial reporting under IFRS as well as the need to address culture if IFRS is to be successful.

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