

GLOBALIZATION AND CULTURAL DIFFERENCES IN FINANCIAL REPORTING

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Abstract

Quality of accounting information determines the quality of information used by financial markets and it is therefore value relevant. Recent development in the area of application of IFRS and growing number of countries, that adopt IFRS standards in their national environment as a vital alternative to national GAAPs reveals that the whole process of harmonisation of accounting and reporting faces a number of issues worth further investigation. The issue of cultural differences and their impact on implementation of international reporting standards has been analysed in scientific literature by both accounting scholars and practitioners. After the compulsory adoption of IFRS by publically listed firms in the EU in 2005, there have emerged many research studies on centripetal and centrifugal forces in financial reporting in various national environments. In our contribution we use a qualitative holistic approach to characterize the influence of cultural factors on adoption of international reporting standards. We attempt to create a coherent roadmap of different layers influencing the dynamics of accepting the common financial rules.

Key words: cultural differences, IFRS, harmonization, quality of accounting information

JEL Code: M21, M41

Introduction

Accounting is a complex socio-economic activity whose evolution is closely linked with development of human civilization and industry development. It is argued that the rise of global capital would not have been possible without the existence of organized and institutionalized accounting practices. As processes of globalization have been increasing and spreading, there have also been calls for harmonization of accounting practices. In this paper we aim to discuss the effort of accounting harmonization and highlight the perceived differences between various countries and cultures.

The investors, decision makers and managers needed to understand the information form other countries to have necessary evidence about productivity and attractiveness of

future prospect of each firm to assess is as an investment alternative. The goal was thus established – to harmonize the accounting standards and procedures used to enable more fluent flow of financial information.

Gradual implementation of IFRS into national economic systems or their spontaneous acceptance as alternatives has now finished but it has not fully replace the original accounting systems and so there is a need to analyse more national cultural specifics. Spontaneous harmonization has occurred in those countries there was not a strong tradition of own national accounting systems or in countries that were influenced economically and culturally by more dominant economies or trading and industrial relations (cf. Chanchani and MacGregor 1999).

1 Previous literature

The field of literature on accounting harmonization and identified accounting differences is very broad. Authors have used both qualitative and quantitative methodology to disclose patterns of accounting harmonization and differences for the overwhelming trend. Cultural environment and its characteristics - recognition of elements and influencing characteristics have been the subject of debate of many articles on the turn of the century. Saudagaran and Dita (1999) state that „formulation of a theoretical framework is also crucial to the on-going debate on accounting harmonization. Specifically the explanations of „how“ and „why“ patterns of cross-national accounting system develop will support either a „culture free“ approach or a „culturally grounded“ approach to accounting development. Is accounting a set of techniques providing unbiased facts or is it the outcome of complex social forces where facts are culturally specific? National environment and its relationship with accounting practices has been a subject of many researches that analysed the effects from many aspects: as a need of economy developing (Perera, 1989, Wallace 1990), the role of religion (O'Connor 1995), development of control systems (Harrison 1992), R. Gray 1988). Chanchani and MacGregor (1999) summarized different views and approaches to the classification of the cultural environment, as well as Saudagaran and Diga (1999). All of these opinions on the structure of the cultural environment, on the elements that make up this cultural environment, differ in details view, in the extent to which include historical aspects to their definition, in the aspects that may affect the accounting system and also in detail with which they view the actual financial system.

2. Analysis

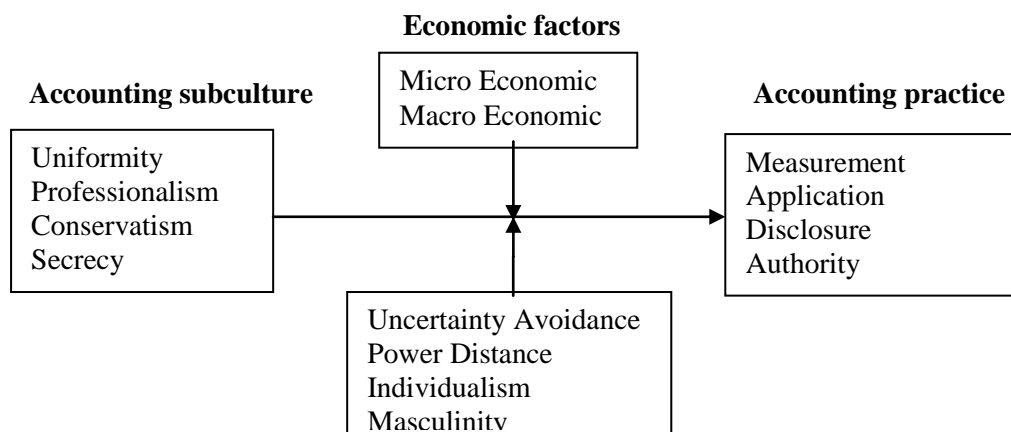
Differences in accounting systems stem from country's legal and cultural background. Cultural background is historically determined by economic, cultural and political evolution of each country. International accounting standards ought to lead to mitigation of differences and to accent the accounting principles – the substance. However, it has been observed to the contrary, that IFRS are becoming “nationalized”. After certain time of usage, IFRS become a part of national financial reporting system. International standards therefore also tend to be influenced by cultural background of each country: i.e., economic development and particular legal environments, accounting “habits” and country tax rules.

Major factor causing differences in interpreting and understanding corporate accounts are attributed to cultural differences. There were various attempts to classify the differences. This factor was originally introduced by Geert Hofstede, who tried to capture cultural difference in an industrial world but not specifically in accounting.

Further research in cultural dimensions is authored by R. Gray, who constructed a set of the accounting value dimensions which form a part of economic surroundings (Figure 1):

1. Professionalism *versus* Statutory Control refers to professional judgment and self-regulation in contrast to compliance with rigid legal requirements and legislative control.
2. Uniformity *versus* Flexibility indicates the level of enforcement of standardized and consistent accounting practices.
3. Conservatism *versus* Optimism indicates a vigilant approach to accounting measurement, as opposed to a more optimistic and risk-taking approach.
4. Secrecy *versus* transparency refers to confidentiality and the constraint of disclosure of information, as opposed to a more transparent and publicly accountable approach.

Figure 1 – Elements of culture environment affecting the accounting system



Cultural factors

Source: Fechner and Kilgore, 1994

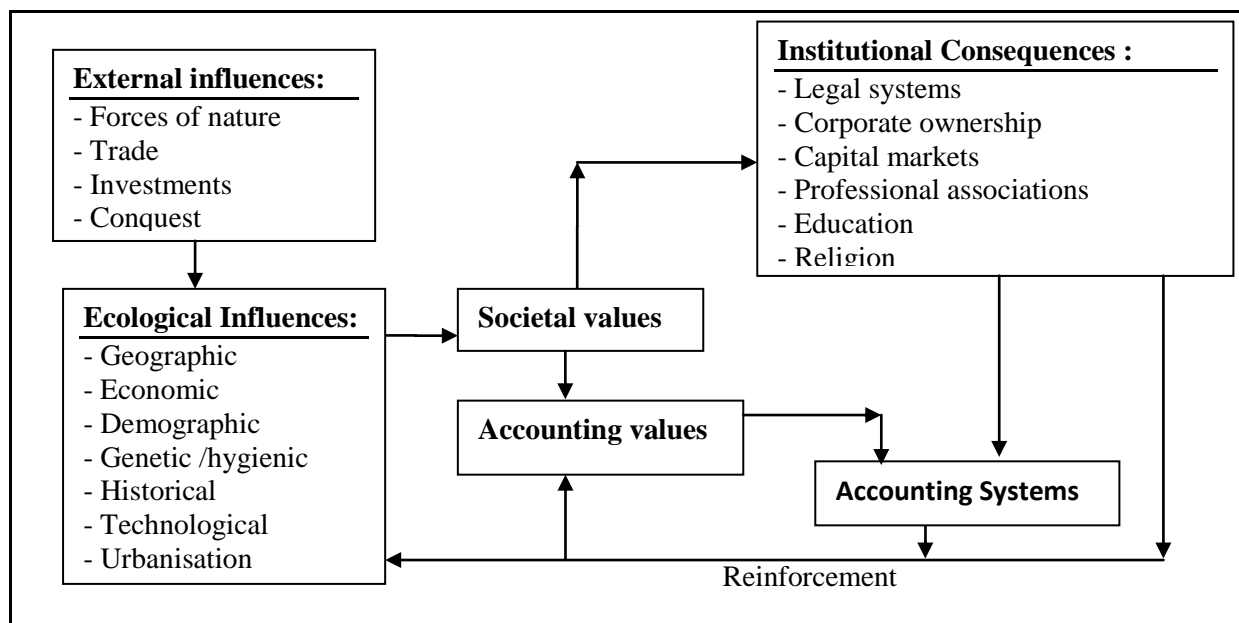
The relation between the four accounting value dimension and the Hofstede four cultural dimensions is shown in Table 1 (Gray, 1988). Wider environment that is reflected in the stated dimensions and determines its final shape and position in the system is now explicitly expressed noted in the accounting value dimensions (see Figure 2).

Table 1 – Societal values and accounting practices

Societal values	Accounting values	Accounting practice
Individualism	Professionalism	Authority
Uncertain Avoidance	Uniformity	Application
Power Distance	Conservatism	Measurement
Masculinity	Secrecy	Disclosure

Source: Adapted from Perera, 1989

Figure 2 – Culture, societal values and the accounting subculture

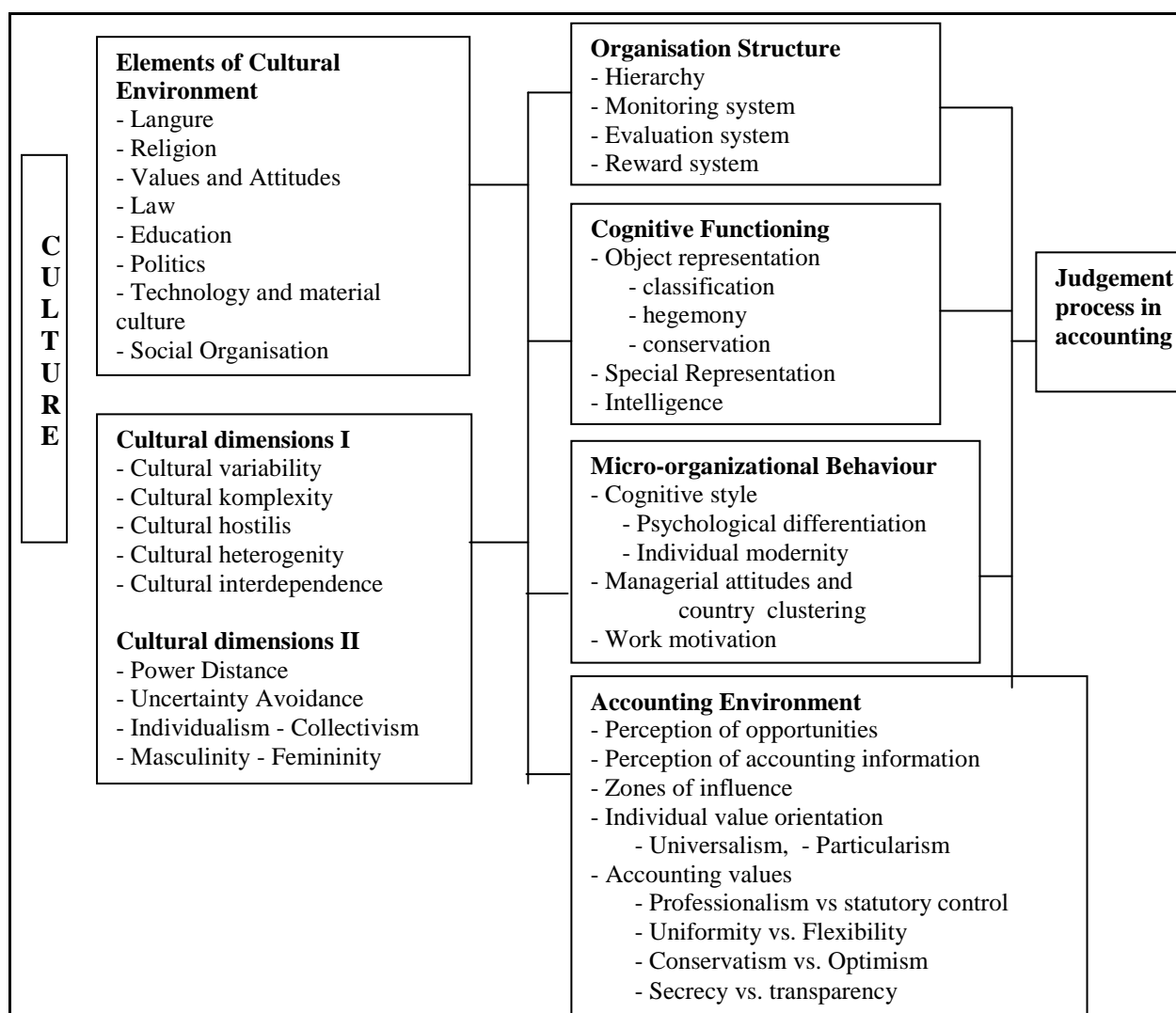


Source: Gray, 1988, p.7

It is clear that these brief schemes do not affect the complex cultural or social environment in its complexity, but allow a focus on the area immediately connected with accounting activities.

Model that offers deep insight into the functioning of social and cultural system with regard to the accounting system was formed R. A. Belkaoui. Belkaoui (1990) explained that the structure of cultural environment affects the accounting system following Hofstede's definition of culture as a collective programming of the mind - an ideological system forming the background for human activity providing people with theoretical reflection of reality. This background is composed of distinct features and it includes a specific elements: language, religion, values and attitudes, which are codified in law, education, politics, technology, material culture, social organization. These elements create cultural model that affects the organization, structure, cognitive functioning of individuals and micro-organizational behaviour, all of which shape the judgmental process in accounting. The structure of components of cultural environment is depicted in figure 3.

Figure 3 – Elements of Cultural environment in accounting



Source: Belkaoui, 1990, p. 41

Culture environment vary along five dimensions: cultural variability, cultural complexity, cultural hostiles, cultural heterogeneity and cultural interdependence. The first three elements refer to conditions within cultures; the latter two refer to conditions among cultures. It is assumed that these five dimensions generate different cultural environments. According to Hofstede's dimensions the cultures vary and from a special orientation of a cultural design of country. Essential argument underlying Belkaoui's model is that cultural processes guide the decision processes in accounting and thus the culture, through its various levels of manifestations determines the organization structure, micro-organization behaviour, the accounting environment and the functioning of individuals facing the accounting sphere.

The following research examined the relationship between selected sub-elements, for example individualism-collectivism in the learning styles of accounting students in special national systems - Australia, Hong Kong and Taiwan (Auyeung and Sands, 1996), interaction between national and organizational cultures at the firm level of a form (Soeters and Schreuder, 1988), interaction between tax rules and practices and financial reporting rules and practices in a country (Lamb et al., 1998), etc.

3. Implications

There were new findings identified since the time when this original model was compiled. They concern mainly the practical implementation of IFRS and further development of knowledge in the field (Albu et al., 2013; Ramanna, Sletten, 2009). Implementation of IFRS in the environment that significantly differs from the place, where the international standards are originating e.g. India, Malaysia, Nigeria. This gives a new impetus to explore which elements constitute specific local cultural environment. Particularly in the CEE, as a specific part of the EU, there are certain external and internal factors forcing the construction of new market-oriented economics, which has significantly different function of accounting system compared to its previous role. This creates a special environment for IFRS implementation in central Europe and challenges the socio economic environment influencing the accounting practices in this space.

Based on this research, experience and knowledge from the process of transformation of accounting, we attempted to identify elements of cultural and economic environment, which are affecting the process of construction of a new accounting system. Each element is

understood as an individual layer of “national arena” as described by Belkaoui, 1990). Cultural layers with a list of sub-elements - their distinguishing constituents are summarized in Table 2.

Table 2 – Different layers of cultural environment with the influence on accounting

Layers			
1. Culture in general (philosophy, ethics)	2. Natural and social environment	3. History, historical experience	4. Organization of society
<ul style="list-style-type: none"> - Religion and related religious values - philosophical perception of the world (western x eastern), individual x holistic - further elements of intellectual culture (painting, music, literature, architecture, relation to nature, time) - general orientation of values (profit x other criteria of success) 	<ul style="list-style-type: none"> - availability of nature resources, - major activity (agriculture, production) - contact with other societies (access to the sea and other cultures) - role of natural environment in the society 	<ul style="list-style-type: none"> - development of economic system as a whole - understanding of success - element of nationality - defensive x offensive elements in history - transferability of historical experience, acceptance of history 	<ul style="list-style-type: none"> - organization of society (centralistic x decentralistic, liberal x absolutistic) - role of law and its enforcement - civic responsibility - design of family
5. Role of man in society	6. Organization of economic life	7. Accounting domain	8. Professional training of accountants
<ul style="list-style-type: none"> - respect and disrespect to man - equality approach to community members - its reflection in institutional setting - requirements of society to individual (its specification and enforcements, demand and enforcement) 	<ul style="list-style-type: none"> - commercial and civic law and its position - overwhelming liberal x non-liberal economic attitudes - experience with centrally planned management - approach and protection of ownership, enforcement of rules - ways of re-allocation of capital and capital sources - existence and role of correcting measures (audit, market supervision). 	<ul style="list-style-type: none"> - role of accounting i society and economic system - Interests of accounting profession and its institutionalization - legal regulation of accounting and its enforceability - role and effect of audit, legal support of audit - role of accounting in society (capital market x taxes) - political aspects of accounting - historical experience from the development of financial reporting 	<ul style="list-style-type: none"> - established requirements on accounting professionals - legal requirements on performance of qualified accountants - system of professional training of accountants - training of accountants and system of education - relation of accounting profession and the system accounting training
9. Accounting profession	10. Technical environment for accounting practice		
<ul style="list-style-type: none"> - selecting and accepting professionals to execute the accounting role 	<ul style="list-style-type: none"> - position of technical equipment - available software 		

<ul style="list-style-type: none"> - supervision of performance of accounting activities - feedback - role and competences of accountants in the firm - ethical codex and practical of accounting profession 	<ul style="list-style-type: none"> - communication IT spec. and accounting profession - Training of accountants and IT specialists - active x passive approach of accountants to IT 		
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Source: own processing

Definition of each layer is based on a comprehensive view of the social movement, which in terms of the transition economies draw attention to the forces at work within it.- factors that influence the adoption of solution, not only in the field of accounting. Unlike previous models, there is greater emphasis on the historical roots of the whole cultural and social system. The influence of historical experience is reflected not only in solutions in the field of legal and economical setup, but necessarily permeates the solutions adopted in the field of financial reporting. This is reflected also in the other layers (position of individual in society, the accepted model of corporate organization etc.). Significant influence of the historical development of the economic system is evident in the existing system of reallocation of capital resources, which determines the range of users of accounting information. Historical experience also represent an important element in accounting. It affects both accepted solution and approach to addressing individual financial situations and their outcomes. Historically it is the position and access to the accounting profession in the economic system. Specifics that feature partial elements of these layers also represent national characteristics in which the individual national systems differ. As important element which form an integral part of national culture can be considered natural resources and the technical level, including the ability to use resources on the one hand and to prepare for their use on the other. Dimensions of culture that were formulated by Hofstede (power distance, individualism, masculinity, uncertain avoidance) have their roots in the reception and inbuilt way of organizing society. From these considerations arises the definition of ten different layers as elements of cultural and social environment.

This is the first attempt at defining elements of the cultural and social environment, which can be seen as affecting the area of accounting. It reveals some limitations and provides suggestions for further research. These limitations can be seen especially in the absence of determination of interactions between the individual layers of which is expected to be the identification of other elements that can be distinguished in the individual layers.

Conclusion

In this contribution the new conceptual roadmap of cultural influences on accounting has been attempted. Further research should focus on refinement of defined layers and their sub-elements. Another direction should be to verify different forms of these layers and elements in the national cultural environments. An important source of knowledge may be gradual implementation of IFRS in different countries, from economically and culturally diverse areas, that may help to identify further elements that distinguish the various national systems and can also translate into solving accounting problems. Another issue worth attention is the impact of spontaneous harmonization on the use of common accounting rules, which is induced by economic activity of large international companies.

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