

# TESTING THE THEORY OF CULTURAL INFLUENCE ON INTERNATIONAL ACCOUNTING PRACTICE

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## ABSTRACT

*The issue of cultural influence in explaining behaviour in social systems has been recognised for some time, however its impact on accounting as a social system is a more recent field of study. This paper will examine the theory of cultural influence on the international practice of accounting and critique the research methodologies used to test this theory.*

## INTRODUCTION - MEASURING INTERNATIONAL CULTURE

Environmental factors including legal systems, sources of external finance, taxation systems, representation by professional accounting bodies, historical inflation, economic and political events are used to help explain international differences in accounting practices (see Nobes and Parker, 2004, pp. 17-31). Another environmental factor that is seen as an influencer on international accounting practice and financial reporting is culture.

Culture may be defined as 'the collective programming of the mind which distinguishes the members of one human group from another' (Hofstede, 1980, p. 25). Each human group shares its own societal norms, consisting of common characteristics, such as a value system which is adopted by the majority of constituents. Values are defined by Hofstede (1980, p. 19) as 'a broad tendency to prefer certain states of affairs over others'. It is these definitions that have been widely adopted in accounting research to develop a cultural framework to investigate international accounting differences.

Hofstede's (1980) work on culture represents the most extensive research on national cultural differences to date (Doupnik & Tsakumis, 2004). From attitude surveys collected from approximately 116,000 IBM employees across 39 countries, Hofstede identified four underlying value dimensions along which each country can be positioned. These societal values are: individualism versus collectivism; large versus small power distance; strong versus weak uncertainty avoidance, and; masculinity versus femininity. Across these dimensions, Hofstede's framework provides quantitative measures for each of the sample countries. This broad sample of quantitative data has attracted many researchers studying cross-cultural differences because the measures are seen as reliable for use as independent variables in statistical analysis. Some of these empirical studies will be examined later in this paper.

## THE IMPACT OF CULTURE IN ACCOUNTING

From the literature and practice, Gray (1988) identified four accounting value dimensions that can be used to define a country's accounting (sub)culture: professionalism versus statutory control; uniformity versus conformity; conservatism versus optimism, and; secrecy versus transparency. The first two dimensions relate to authority and enforcement of accounting practice at a country level, and the second two relate to the measurement and disclosure of accounting information at a country level.

Gray (1988) extends Hofstede's model by overlaying accounting values and systems and their links to societal values and institutional norms. Gray posits that accountants' value systems are related to and derived from the unique societal values in each country. Essentially, accounting values, in turn, affect accounting systems, therefore cultural factors directly influence the development of accounting and financial reporting systems at a country level (Doupnik & Tsakumis, 2004).

Gray introduced four propositions that hypothesise relationships between Hofstede's cultural dimensions and his accounting value dimensions. Gray argues that shared cultural values within a country lead to shared accounting values, which in turn influences the nature of a nation's accounting system (Doupnik & Tsakumis, 2004). Gray never operationalised the hypothesis or conducted empirical tests to support his framework, rather this has been left to other accounting researchers to prove its validity and this is the focus of the next section.

### EMPIRICAL TESTS OF THE HOFSTEDE–GRAY FRAMEWORK

There have been several contributions in the literature attempting to extend or refine the Hofstede–Gray framework in understanding the influence of culture on accounting (e.g., Perera 1989; Fechner and Kilgore 1994; Baydoun and Willett 1995). Chanchani and MacGregor (1999) have examined the literature focused on the conceptual and theoretical issues of the Hofstede–Gray model, while Doupnik & Tsakumis (2004), have investigated the literature concerning the empirical testing of the theory relating culture to global diversity in financial reporting. Doupnik & Tsakumis (2004) attempted to determine whether the Gray (1988) framework had been subjected to adequate empirical inquiry so as to prove its validity, and summarised the research methodologies employed to test the theory by looking at: country level tests; studies testing all four hypotheses; studies testing one hypothesis only, and; testing at an individual level only (rather than a collective level).

Eddie (1990) provided the first empirical test of Gray's framework, testing all four hypotheses. The research methodology to test the theory constructed an index of accounting values for thirteen Asian-pacific countries and then correlated them with Hofstede's cultural dimensions. Encouragingly, the predicted signs of association were confirmed, however, the accounting value constructs and their method of measurement were not rigorous and had no independent validation, and as such these findings were quickly dismissed.

Salter and Niswander (1995) use regression analysis to test Gray's hypotheses holding Hofstede's cultural dimensions as the independent variables. Expanding Eddie's (1990) study to include 29 countries, Salter and Niswander (1995) found significant correlation between only six of the 13 relationships Gray hypothesised between cultural dimensions and accounting values, suggesting that only some elements of Gray's theory were valid.

Sudarwan and Fogarty (1996) independently developed their own measure of cultural values abandoning the Hofstede (1980) index score. Their research methodology used structural equation modelling to test Gray's hypotheses against a longitudinal study of a single country, Indonesia. Overall, they find support for only four of the Gray's 13 hypotheses, suggesting a general lack of support for the framework.

Moving away from testing all hypotheses, Gray and Vint (1995) tested only one dimension of Gray's (1988) hypothesis; that of secrecy. The attitudes of local partners of an international accounting firm were surveyed to understand secrecy with respect to disclosure practices. The results covered 27 countries and using regression, Gray and Vint (1995) found correlations that supported Gray's (1988) original hypotheses with respect to secrecy.

Zarzeski (1996) looked at not only culture being a determinant of accounting practice, but also the demands of international owners of the firm. She found correlations that supported some of Gray's (1988) hypotheses and evidence that firms disclose differently (different accounting practices) in their host country depending upon the internationality of the firm.

Wingate (1997) also looked at a single dimension and examined the influence of culture on amount of disclosure. Using independent data on financial disclosure as the dependent variable, and Hofstede's (1980) index score as the independent variable for all 39 countries, she found that, contrary to Gray's (1988) hypotheses, Power Distance is not significantly related to disclosure.

Using the same independent data on financial disclosure as Wingate (1997), Jaggi and Low (2000) look at the issue of culture, accounting disclosure and another environmental factor, the legal

system, using data from three code law countries and three common law countries. For the common law countries, none of the cultural variables were significant. For the code law countries, all of the cultural variables were significant but only one dimension acted along Gray's (1988) hypothesised direction. Jaggi and Low (2000) concluded not only that Gray's (1988) hypotheses with regard to single dimension of secrecy versus transparency was not valid, but also that the Hofstede culture indices, originally developed in the 1970's, may be outdated.. Also, because the Hofstede culture indices were obtained from only one company, IBM, they may not reflect the diversity of attitudes within each of the 39 countries. The findings put forward by Jaggi and Low (2000) suggest that "culture has little or no influence on the disclosure levels once legal system is considered" (Doupnik and Tsakumis, 2004).

However, Hope (2003) carried the Jaggi and Low (2000) study across all 39 countries for a three-year period (1993 to 1995). Using a larger sample he gets mixed results across Gray's (1988) hypotheses, but triumphantly declares that "it is too early to write off culture as an explanatory variable for annual report disclosure levels" (Hope, 2003, p. 23).

### CONCLUSION

Understanding the impact that environmental factors such as culture have on accounting practice and financial disclosure is important as we move towards international accounting harmonisation. Any insights into how local values may percolate through the accounting treatment and ultimately impact financial disclosure is important to ensure the comparability of international financial reporting.

Gray's (1988) framework has raised expectations about how culture may influence accounting practice at a national level. However, empirical research into this question has not demonstrated satisfactorily any proof to support the hypotheses.

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