

## **CHAPTER TWO**

### **INTERNATIONAL ACCOUNTING PATTERNS, AND DEVELOPMENT**

#### **CHAPTER OUTLINE**

1. Purposes of International Classification
2. Classification of Accounting and Reporting Systems
  1. The Directive Approach
  2. The Inductive Approach
3. Cultural Influences on Accounting Development
4. Culture, Societal Values, and Accounting
  1. Structural Elements of Culture that Affect Business
    1. Individualism versus Collectivism
    2. Large versus Small Power Distance
    3. Strong versus Weak Uncertainty Avoidance
    4. Masculinity versus Femininity
    5. Confucian Dynamism
  2. Accounting Values
    1. Professionalism versus Statutory Control
    2. Uniformity versus Flexibility
    3. Conservatism versus Optimism
    4. Secrecy versus Transparency
  3. Accounting Values and International Classification
5. International Pressures for Accounting Change
6. Summary

#### **CHAPTER OVERVIEW AND TEACHING SUGGESTIONS**

Chapter 2 is a key chapter, because it establishes the cultural foundation for accounting standards and practices. The first part of the chapter provides different ways to classify countries according to accounting practices. Special attention should be placed on the Nobes model, even though it only includes a few countries and is relatively subjective. The next significant part of the chapter relates Hofstede's research on cultural values with Gray's discussion of accounting values. Gray's model is a helpful model to use when discussing countries. One effective way to bridge Hofstede and Gray is to discuss Exhibit 2.1 with books closed so that the students have to figure out whether the columns and rows are positively or negatively correlated. There may be some disagreement as to whether Figures 2.4 and 2.5 are accurate, but they are a good place to begin the discussion of how culture influences authority and enforcement, and measurement and disclosure practices.

The final portion of the chapter discusses international developmental influences and current trends of accounting systems. Classroom discussions can formulated as to the impact of these factors upon accounting development and accounting principles and practices. In addition

to the two cases at the end of this chapter, there are also several study questions and discussion points at the end of the chapter that can be used as a basis for the class discussion.

## **LECTURE NOTES**

- I. Purposes of International Classification
  - A. To sharpen description, analysis, prediction
  - B. To help describe and compare different national systems in order to better understand them; and to learn
    - 1. The extent to which national systems are similar/dissimilar
    - 2. The pattern of development of systems--potential for change
    - 3. The reasons why some systems dominate others
  - C. To assess prospects for harmonization
  - D. To help national policy makers determine what to do
  - E. To help developing countries choose appropriate systems
  - F. To help MNEs overcome problems of establishing control systems
- II. Classification of Accounting and Reporting Systems
  - A. Deductive Approaches
    - 1. Identify relevant environmental factors and link them to national practices
    - 2. Group countries together based on (1)
    - 3. Mueller(1967) identifies four approaches, but there are limitations
      - A. . Classifies business environments according to economic development, business complexity, political and social climates, legal systems
      - B. Assumes that countries in each group have similar accounting practices but does not specifically link them
        - I. Macroeconomic--business accounting correlates closely with national economic policy; (E. G. , Sweden, France, Germany)
        - iI. Microeconomic--accounting is viewed as a branch of business economics; economic analysis, replacement value, managerial emphasis; (E. G. , Netherlands)
        - iiI. Independent discipline--accounting is derived from business practice; pragmatism, judgment, conceptual framework; (E. G. , United States and United Kingdom)
        - iv. Uniform accounting--accounting is an efficient means of administration and control; same accounting for all users; (E. G. , France, Germany, Sweden, Switzerland)
        - v. Mueller's limitations are: 1) does not specifically show how these factors relate to groupings; 2) very judgmental; 3) no reference to culture
    - 4. Nobes(1983) expands upon Muller(1967). See Figure 2.1, Exhibit 2.1
      - A. Establishes a hierarchy similar to natural science
      - B. Uses questionnaires and personal judgment on measurement and valuation practices of 14 countries. Results indicate macro/micro

classification.

- C. Is hard to allocate to countries; not mutually exclusive to a group
- D. Has no specific focus on culture

#### B. Inductive approach

- 1. Accounting practices are analyzed and used to develop accounting groups
- 2. Nair and Frank (1980) studies
  - A. Use PW 1973-1975 surveys and factor analysis
  - B. Differentiate measurement and disclosure
- 3. 1973 PW Survey
  - A. Has four measurement groups--British Commonwealth, Latin America, Continental European, U.S.
  - B. Has seven disclosure groups with no logic or proof
- 4. 1975 PW Survey
  - A. Has five measurement groups: British Commonwealth, Latin American/South European, Northern/Central European, U.S., Chile -- see Exhibit 2.2
  - B. Has same problem of 1973 survey with disclosure groups
  - C. Was used by Nair and Frank to assess relationships among groups with explanatory variables--could not support culture with disclosure or trading factors with measurement
- 5. The PW data has lots of problems

#### C. Conclusions

- 1. Classification schema has room for improvement
- 2. Establishment of relationships between environmental factors and accounting systems is important

### III. Cultural Influences on Accounting Development

#### A. Culture

- 1. Culture is essential to help understand how social systems change, because it influences
  - A. Norms--values of social systems
  - B. Behavior of groups in their interaction within and across systems
  - C. Accounting subculture Gray Figure 2.3

### IV. Culture, Societal Values, and Accounting

- A. Hofstede (1980 1984) investigates structural elements of culture that affect behavior in work, organizations and institutions; updated his work with summary (2001)
  - 1. Determination of values of employees of an MNE located in more than 50 countries
  - 2. Four basic value systems from Hofstede:
    - A. Individualism
    - B. Power distance
    - C. Uncertainty avoidance
    - D. Masculinity
  - 3. Further research (1988) revealed a fifth dimension--Confucian Dynamism or

- short-term versus long-term orientation
4. Value dimensions are used to cluster countries into groups
  5. Hypothesis: cultural areas and patterns of accounting systems should match up
  6. Relationship between cultural values and accounting values should exist
- B. Hofstede sets values dimensions
1. Individualism vs. collectivism
    - A. Individualism--loosely knit social framework where individuals take care of the values
    - B. Collectivism--interdependence, loyalty, tightly knit social group
  2. Large vs. small power distance
    - A. Large distance--people accept a hierarchical order and need no justification
    - B. Small distance--people strive for power equalization and demand justification for inequalities
  3. Strong vs. weak uncertainty avoidance
    - A. Strong--rigid codes of belief and behavior; intolerance toward deviants
    - B. Weak--relaxed; practice more important than principles
  4. Masculinity vs. femininity
    - A. Masculinity--preference for achievement, heroism, assertiveness, material success
    - B. Femininity--preference for relationships, modesty, caring for the weak, quality of life
  5. Short- vs. long-term orientation
    - A. Short-term--preference for quick results, respect for social status regardless of cost, small savings levels and low investments
    - B. Long-term--perseverance toward achieving gradual results, a thrifty and sparing approach to resources, large savings levels and investments
- C. Accounting values dimensions proposed by Gray (1988)
1. Professionalism vs. statutory control
  2. Uniformity vs. flexibility
  3. Conservatism vs. optimism
  4. Secrecy vs. transparency
- D. Relationship between accounting values and societal values -- see Exhibit 2.4
1. Professionalism
    - A. Judgments by independent professionals
    - B. True and fair view
    - C. Related to individualism, weak uncertainty avoidance, small power distance
  2. Statutory control
    - A. Public regulation, statutory control
    - B. Large power distance
    - C. Strong uncertainty avoidance
  3. Uniformity

- A. Uniformity, consistency, comparability
  - B. Strong uncertainty avoidance, collectivism, large power distance
  - 4. Flexibility
    - A. Individualism, weak uncertainty avoidance, small power distance
  - 5. Conservatism
    - A. Conservatism is a continuum with Japanese, Swiss, French, German vs. U.S., U.K., Dutch
    - B. Conservatism is influenced by concern with security, uncertainty of future events, and governmental involvement
    - C. Strong uncertainty avoidance, long-term orientation
  - 6. Optimism
    - A. Concern for short-term results, stock market pressures
    - B. High levels of individualism and masculinity, weak uncertainty avoidance
  - 7. Secrecy
    - A. Influence of management on quality and quantity of information disclosed to outsiders
    - B. Secrecy related to disclosure, conservatism relates to measurement
    - C. Hidden accounting reserves
    - D. Strong uncertainty avoidance, high power distance societies, collectivism, long-term orientation
  - 8. Transparency--openness
    - A. Capital markets characteristics, public ownership of shares, voluntary disclosure
    - B. Individualism, small power distance, weak uncertainty avoidance
  - D. Accounting Values and International Classification
    - 1. Link between accounting values and specific accounting system characteristics--see Figure 2.4
    - 2. Accounting values most relevant to the professional or statutory authority for accounting systems and their enforcement would be professionalism and uniformity--see Figure 2.5
    - 3. Accounting values most closely related to measurement practices would be conservatism and secrecy--see Figure 2.6
    - 4. Empirical research to date supports the significance of accounting values to explain cross-national difference in accounting practice
- V. International Pressures for Accounting Change
- A. Major pressures for change -- see Figure 2.7
    - 1. Growing international economic/political interdependence
      - A. East vs. West, North vs. South distinctions exist
      - B. Evolution to market economies by Centrally Planned Economies continues
      - C. Privatization and deregulation is everywhere
      - D. European Union -- economic integration increases

- i. UN, OECD
- 2. New trends in foreign direct investment
- 3. Changes in multinational corporate strategy
- 4. More accountability to employees
- 5. The impact of new technology (internet)
- 6. Environmental impact of MNEs
- 7. The rapid growth of international financial markets
- 8. Expansion in business services
- 9. Activities of international regulatory organizations.

