

# Adopting the international accounting standards issued by the iasb



According to a report published by IASB in 2008, more than one hundred countries throughout the world have adopted and announced the international accounting standards issued by the IASB. However, the cross-country diversity in financial reporting and auditing practices has not been reduced by global acceptance of international accounting and auditing standards. This diversity acts as a barrier for different country companies to perform globe transactions and investors to gain access to foreign capital market (Doupnik, 2004).

Many previous studies had shown that there are many causes for differences in accounting practices between different countries. Those causes or factors such as taxation regulation, cultural, nature of capital market and legal system are the major obstacles in harmonizing accounting principles and standards on globe basis (eg, McComb (1980), Meek and Saudagaran (1990) and Heidhues and Patel (2010)). However, before investigating the effect of those factors on financial reporting harmonization, it is necessary to indicate whether those factors have an impact on the century's accounting system establishment. Since culture can significantly affect the human activity, particularly accountant's activity among countries, there is a growing number of studies emphasis that culture is major powerful environmental factor which influence accounting practice through the norms and values held by members of accounting system (Doupnik and Salter, 1995; Ding et al., 2005; Patel, 2003). According to Doupnik and Tsakumis (2004), the different culture can influence the attitude of accountants in interpreting and applying financial reporting standards even though the standards have been consistently adopted across these groups. More importantly, based on the

Hofstede's (1980) four cultural dimensions, Gray (1989) developed four accounting values dimensions held by members of the accounting sub-culture and proposed 13 relationships between the accounting values and Hofstede's (1980) four cultural dimensions. On one hand, Gray's framework can expose an understanding of how culture affects the interpretations and judgments of accountants. on the other hand, it contributes to explain and predict international differences in accounting systems, which potentially benefit for accounting development internationally. However, the Hofstede-Gray framework of the influence of culture on accounting practice has been argued to be conceptually inadequate to explain the depth, richness and complexity of culture (Gernon & Wallace, 1995; Chow et al., 1999; Harrison & McKinnon, 1999). So this essay will critically assess the reasoning that underlies Gray's (1988) theory of accounting culture and the applicability of the theory in the area of increasing use of IFRS.

## 1, Brief description of culture and value

Hofstede (1980) describes culture as ' the interactive aggregate of common characteristics that influence a human group's response to its environment' (p. 10). more recently, Matsumoto and Juang (2004, p. 7) constructed a comprehensive definition of culture as ' a dynamic system of rules, explicit and implicit, established by groups in order to ensure their survival, involving attitudes, values, beliefs, norms, and behaviours shared by a group'.

Therefore, Culture represents the average tendency in the values, beliefs, attitudes and behaviours that are shared by a group of people. Additionally, Hofstede (2001) emphasis that value is the core item of culture and defined it as ' broad tendencies to prefer certain states of affairs over others'. Bilsky <https://assignbuster.com/adopting-the-international-accounting-standards-issued-by-the-iasb/>

(1987, p. 551) provided a more detailed definition of values. ' Values are concepts or beliefs, about desirable end states or behaviours, that transcend specific situations, guide selection or evaluation of behaviour and events, and are ordered by relative importance'. Consequently, value may be important motivational factors which influence the attitude of accountant in accounting practice. However, culture is a very complex variable which is hard to be used as independent variables in statistical analyses. In order to examine the relationship between the culture and accounting practice, there is a greater demand of quantitative measures dimensions of culture by country.

Brief description of Hofsted's culture framework and Gray's theory of accounting sub-culture

According to an attitude survey of approximately 116000 IBM employees in 50 countries from 1967 to 1973, Hofsted (1980) format and stabilize societal culture into 4 value dimensions which are Individualism, Power Distance, Uncertainty Avoidance and Masculinity. Those four dimensions attempt to explain the difference and similarities in culture around the world (Doupnil, 2004). Though much empirical evidence show that those cultural dimentions is far from complete and less objective, the biggest contribution of Hofsted's cultural dimensions is that it develop groundwork for establishing linkage between specific culture and specific attributes of financial reporting practice (Doupnik, 2004).

Source: (Foo, 2008)

Gray(1988) argued that the value or attitudes of accountants derived from societal values would impact on the development of accounting systems. Therefore, according to a review of accounting literature and practice, Gray(1988) extends Hofsted's theoretical framework to develop a model that identifies 4 widely recognized accounting values that links Hofstede's (1980) societal culture values and the development of accounting systems in practice. Gray (1988) describes these accounting subculture values in following table:

Then, Gray add two elements of accounting values and accounting systems into Hofstede's framework in order to reflect the interaction between the societal values, institutional

Structure and accounting practice. This new extended framework can be described in the following figure.

According to this figure, on one hand, societal value affects both accounting values and institutional consequences such as legal systems, corporate ownership and capital market. On the other hand, accounting system is influenced by accounting values and institutional consequences. So the societal value indirectly associated with the establishment of accounting system. At the same time, Gray hypothesized four attributes of national accounting system-authority, enforcement, measurement and disclosure. Specifically, Grey suggested that professionalism and uniformity are more relevant to authority and enforcement for accounting system. conservatism is more relevant to accounting measurement and secrecy is more relevant to accounting information disclosure. Furthermore, Gray introduced 4

hypotheses regarding with 13 relationships between accounting value and Hofstede's cultural dimensions. Those hypotheses will be illustrated in the following table.

Source : Foo (2008)

Critically evaluate validity of Gray's hypothesis and accounting value dimensions

1, professionalism versus statutory control

Gray (1988) suggested that professional accounting involve greater individual professional judgments, and the professional accountants are perceived to own an independent position which should not be subject to statutory controls. Some developed countries such as UK and USA combined professionalism with principle -based accounting which means accountants relies on their independent professional judgement to present a ' true and fair view of company's financial situation (Gray, 1988). Because individualistic society emphasise the importance of individual independence and the respect of individual decisions; weak uncertainty avoidance society emphasise the importance of practice rather than rules, and where a greater and easier tolerance of variations in professional judgement; Small power distance society emphasise the importance of equal rights, where there is a greater acceptance of other people's opinion (Foo, 2008), so, under above three cultural environments, there is a preference of professionalism rather than statutory control. In Patel's (2003) study, he found that ' Australian professional accountants were more inclined to engage in whistle-blowing as an internal control mechanism than their Indian and Chinese-Malaysian

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counterparts'. Furthermore, Patel (2003) concluded that the reason which was driving Australian accountant's judgments regarding the acceptance of whistle-blowing is their cultural background of lower power distance and higher individualism scores. So Patel's study partially supports Grey's professionalism theory. However, through employing a regression analysis to examine the validity of Gray's hypotheses based on a sample of 50 countries, Salter and Niswander (1995) found that just one component of professionalism hypothesis is supported - weak uncertainty avoidance lead to higher professional. While such a connection between uncertainty avoidance and professionalism may be superfluous (Baydoun & Willett, 1995), because uncertainty avoidance itself refers to statutory control, which means society have greater control over the profession through rules and regulations (Hofstede, 2001). Hence, " the concept of uncertainty avoidance and statutory control, the inverse of professionalism, is arguably analogous"(Foo, 2008)

In sum, to a certain extent, those cultural demintions can influence accounting professional.

#### Uniformity versus flexibility

" Uniformity or flexibility would seem to be a significant accounting value dimension because attitudes about uniformity, consistency or comparability are incorporated as a fundamental feature of accounting principles world-wide" (Gray, 1988). For example, a country, such as Grammy, requires that its accounting practice must base on tax purpose, so a uniform accounting principle in this country will facilitate national planning and comparability

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between companies. When a society appear to be a strong uncertainty avoidance, human activity, such as accountant activity, will be restricted by rigid laws and regulation. So the accountant prefer to perform a stable and uniform accounting practice in order to avoid punishment of law.

Consequently, Gray (1988) hypothesised that uniformity is consistent with a strong uncertainty avoidance society. Moreover, Gray also argued that uniformity is favoured by collectivistic society, because there is a 'tightly knit social framework, a belief in organisation and order, and respect for group norms'. Furthermore, since the imposition of laws is more likely to be accepted by accountants who work at a large power distance society, Gray also suggested that there is a positive association between uniformity and large power distance society. However, it should be note that uniformity not only related to authority classified by Gray (1988), but also should be associated with measurement and disclose practice. Because accounting value of uniformity may significant affect the consistency and comparability of the form and content of financial statements(), it could influence the measurement of asset and the decision of information disclosure. Therefore, Grey simplify classified uniformity as accounting authority perspective, which may be not very accurate.

### Conservatism versus optimism

Conservatism mainly refers to a kinds of accountant's attitude that how they perform the accounting valuation (Sterling, 1967). It can be considered as significant value dimensions of accountants that influence their accounting practice. Since creative or optimise accounting procedure usually generate a uncertain result of future events, accountants who work at strong  
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uncertainty avoidance country which is more concerned with the conformity of laws and regulation, would prefer to perform more conservative accounting procedure, such as historical costing to the measurement of asset, in order to cope with uncertainty of future events (Gray, 1998). For example, despite carrying value of fixed assets only reflects the unallocated amounts rather than expected benefits and that goodwill intrinsically has greater uncertainty and is not subject to annual amortisation under depreciation allocation process (Alfredson et al., 2009), some strong uncertainty avoidance countries, such as France and Germany, still would like to use historical costing to measure the fixed assets. In addition, though Consolidated financial statements is very important to represent the true and fair view of the financial performance of group as a whole, there is a less preference for implementing this financial statement in the tax based countries like Germany, primary because the accounting law in Germany don't require the preparation of consolidated financial statement until 1970s. Therefore, Gray's hypothesis that conservatism is closely consistent with strong uncertainty avoidance society has been significantly supported by many evidences. Gray further argued that there is a less strong link between high levels of individualism and masculinity in a society and the preference for conservatism. In societies where individual achievement and performance is emphasised, it is likely that a less conservative measurement approach will encouraged.

### Secrecy versus transparency

Secrecy or transparency mainly reflects the extent of accounting information disclosed. When an accountant have a secret attitude to perform accounting <https://assignbuster.com/adopting-the-international-accounting-standards-issued-by-the-iasb/>

practice, there would be only a minimum amount of detailed financial data should be included in financial statement. Though Secrecy usually decrease the usefulness of accounting information for outside users, restricted information disclosure can effectively avoid disagreements, misunderstandings and conflict and to preserve security. Therefore, on one hand, a preference for secrecy is more consistent with a preference for strong uncertainty avoidance society where is more concerned with security and conformity rather than uncertainty. On the one hand, secrecy is also considered to be significantly associated with large power distance society where is a preference to restrict disclosure of information to preserve power structures(). In addition, Gray (1988) also suggested that more collectivistic society and more masculine society may be more secret to the disclosure of information, because collective society are more likely to keep information within the firm rather than disclosing it to external parties and a less masculine society prefer to emphasise quality of life the environment (Foo, 2008). Furthermore, through a survey of international firms in 27 countries, Gray and Vint (1995) used regression analysis to test the validity of Gray's secrecy hypothesis. According to Gray and Vint's regression result, individualism and Masulinity are positively associated with accounting disclosure score, while uncertainty avoidance and power distance are negatively related to accounting disclosure score, so all of Gray's secrecy hypotheses have been supported.

In addition, in order to examine the effect of culture on the amount of accounting disclose, Wingate (1997) and Jaggi and Low(2000) separately used CIFAR's 1991 and 1993 international financial reporting index as the

dependent variable to measure the disclosure. However, Wingate's regression result firstly shown that only two component of Gray's secrecy hypothesis have been supported. Moreover, Jaggi and Low's finding just supported one component of Gray's secrecy hypothesis. At the same time, Jaggi and Low emphasised that adding legal system into regression model will lead the sign of coefficients on all of the Hofested's cultural detentions to be insignificant. Furthermore, Heidhues and Patel (2010) suggested that Grey's secrecy theory is over-simplified, and they emphasis the importance of legal, historical, capitalist factors in explaining the deference of accounting system among countries. Heidhues and Patel (2010) use a case of German secret accounting system to against the Grey's secrecy hypothesis. Since bank in German is major provider of capital for enterprise, it had extensive ownership in companies and dominated the stock exchange. As a result, accounting regulation must base on a principle of ' bank protection'. On one hand, bank doesn't want the company to disclose much more accounting information to the other parity due to self protection. On the other hand, banks are more concentrated on whether the enterprises have enough earning to pay the loans, and they may not necessarily need detailed accounting information, Consequently, Heidhues and Patel (2010) argued that accounting system should be critically examined in its context rather than formulating accounting models based on the relationship with culture. In my opinion, Heihues and Patel (2010) may misunderstand the Hofested's cultural framework. They argued that the one of biggest reason which lead to a restricted accounting disclose system in German is the specific capitalist system rather than culture, but the establishment and form of this specific capitalist system is positively associated with uncertainty

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avoidance and power distance. When a society emphasizes the conformity of laws and regulation and the acceptance of unequal rights among peoples, the interdependence between law, state and banks can be maintained in Germany market. Therefore, Gray's secrecy hypothesis should be supported in Germany accounting market.

In sum, according to the hypothesised strength of those relationships, it is easier to find that uncertainty avoidance and individualism are the most important cultural dimensions affecting the accounting sub-culture (Gray, 1988). While masculinity just appears to be a weak association with conservatism and secrecy, so it may be less important in explaining the influence of culture on accounting values. Additionally, many empirical evidences shown that not all of Gray's 13 hypothesis are significant and valid, but those 4 accounting value at least match one of each cultural dimensions. So, to some extent, the deference of accounting system among countries can be explained by the cultural influence, however, it should be note that there are some limitations of Gray's accounting culture theory. Firstly, the validity of Grey's theory largely relies on the accuracy of Hofstede's cultural dimensions. Since culture is a very complex variables which is hand to define, just base on a survey result of 116 IBM employee's view in 50 countries, that will be a huge limitation for accuracy of cultural dimensions. Secondly, Grey's accounting value diminsions was obtained form a review of previous accounting literature, this may be incomplete and less objective to reflect the accounting practice comprehensively. Thirdly, Gery and Hofstede's accounting cultural framework cannot explain the

change in accounting practice when some international accounting requirement has been applied.

The applicability of Grey's theory in using IFRS

With the growing globalization of capital market and the availability of instantaneous global communication, there is appear to greater recognition of the importance of having a common and consistent financial reporting framework and standards among both public and private sectors. By harmonizing financial reporting principle, the differences in financial reporting practice among different countries are reduced, resulting in an increased usefulness and compatibility of accounting practice (Rivera, 1989). For example, investor who wants to buy shares of another country's company would like to require unified financial reports to analyze in order to make an accurate investment decision. Consequently, international organizations such as the International Accounting Standards Committee (IASC) and International Accounting Standard Board (IASB) have concerted efforts to push for the international convergence of a single set of globally accepted financial reporting framework and standards (Foo et al. 2008).

IFRS is international accounting standard which aims to provide a global framework for how public companies prepare and disclose their financial statements (). The IFRS strive to be principles-based, which provides general guidance for the preparation of financial statements, drawn clearly from the IASB's conceptual, rather than setting rules for industry-specific reporting (). More importantly, it should be note that IFRS and IAS strongly rely on the accountant's professional judgments in order to realize ' substance-over-

form' approach. Currently, over 100 countries require their public or private company to adopt IFRS, primarily because IFRS can increase the comparability of accounting information around the world, and thus, improve market liquidity and reduce cost of capital. Moreover, IFRS also take advantage of cost saving for multinational companies who prepare more types of financial statement due to several accounting standards. Generally speaking, increased using of IFRS is a major reason which leads a change in countries original accounting system, while Gray's accounting values and culture area classifications for some countries appear to be insignificant and invalid. In the following I will use a case of continental Europe countries to examine the applicability of Gray's theory.

In 2005, European Union required all Continental Europe countries list company to adopt IFRS. The accounting practice and regulation in those companies has been changed. According to Gray (1988)'s classifications, the accounting values in some developed Continental Europe countries, such as Germany and France, are professionalism, uniformity, secrecy and conservatism. The major cultural dimensions are strong uncertainty avoidance and power distance. This is primarily because that the accounting practice and regulation in Germany and France are contained in code law and the accounting approach should be consistent with tax purpose (Germany) and macroeconomic purpose (France), and both two countries' accounting practice are rule based.

As above mentioned, in order to prepare the true and fair view for company's position, IFRS emphasis the 'substance over form' approach, resulting in a greater reliance on professional judgments. In other words, <https://assignbuster.com/adopting-the-international-accounting-standards-issued-by-the-iasb/>

IFRS requires more discretion. Though IFRS provide more guidance and standards, it does not have guidance applications, giving more room to interpretation (). Thus, this discretion will transfer the rule-based accounting to principle based accounting. For example, IFRS require using fair value to measure company's fixed assets. But the accuracy of fair value may be affected by many subjective factors, such as manager's interests and external environments. The use of fair value is congruous with increasing the amount of discretion given to managers and accountants (Watts, 2003). Therefore, Gray's accounting value of conservatism and uniformity concerning with Germany and France should be changed to optimism and flexibility due to increased using of IFRS in those two countries.

In addition to discretion, IFRS can increase the transparency of company financial report throughout higher quality and detailed standards. Due to the specific capital market and the nature of ownership, Continental Europe countries, such as Germany and France are likely to perform 'hidden reserves' which is a bundle of money that a company creates by increasing an expense account (Wu, 6). Since many companies prefer to create 'hidden reserves' for unpredictable future loss, the external financial statement users would not know the real performance of the companies. For example, Germany GAAP requires that the provision can be set when no obligation, which would be a kinds of method to hide reserves. In contrast, IFRS require that provision can be set only when obligation occur. Therefore, through using IFRS, such as 'impairment asset', 'financial instruments', 'provision and contangiabe asset and liability', this accounting practice can be prohibited, resulted in a more relevant and reliable financial reports of

company's economic position. With the increased using of IFRS, the accounting value of secrecy in Germany and France should transfer to transparency.

However, according to above features of IFRS, Gray's accounting value classifications for USA and UK appear to be correct and significant. The reason may be that the original accounting environment of UK and USA is quite similar with IFRS's requirement.

## **Conclusion**

This essay critically accesses the Grey's 13 hypotheses regarding with the association between accounting value and cultural dimensions. Though many evidence show that Grey's hypotheses and accounting value dimension are not very effective to analyses the accounting system difference among countries, it at least provide a logical link between culture and accounting practice, which is contributed to exploration of further research. Additionally, through analyzing the case of Germany and France, Grey's theory is not applicable for some countries, such as Continental Europe countries, which increased using IFRS. But we could not simply believe that Grey's classification is invalid and culture is not important in influencing accounting system, because the adoption of IFRS also reinforces the changes in culture. Only when culture is consistent with the adoption of IFRS, the accounting system would become more effective and stable.