

## **The Effect of Culture on Accounting System's in China**

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## Abstract

*This paper investigates the effect of cultural influences on the international practice of accounting. We critique the contemporary research methodologies used to test this theory and proposed our methodology. We proposed to perform an empirical test using China firms. The cultural dimensions of Uncertainty Avoidance, Individualism, Power Distance, Masculinity and Long term Orientation is compared between USA and China accountants to discover whether Chinese accountants will exhibit stronger conservatism and secrecy when compared to US counterparts. National culture has a significant effect on the judgments of accountant when interpreting and applying selected IFRSs that contain uncertainty expressions. 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.*

Keywords: Accounting convergence, uncertainty expressions, education, culture, accounting judgments

## I. Introduction

In 1979 China changed its economic system from centrally planned to market economy. The State Council changed all accounting regulations and systems to facilitate the development of China new legal and accounting system (Chow, 2001). The accounting system, culture and education back then were vastly different from the West. Adherence to international standards, developed by the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board (IAASB), can lead to greater economic expansion. (Wong, 2004)

The inconsistent accounting practices found in different parts of the world have always concerned accounting researchers (Mueller, 1965; Lin and Wang, 2001; Gujarathi, 2008). Globalization of businesses and markets demanded a financial reporting framework that abides to international accepted auditing standards (Wong, 2004). More than one hundred countries throughout the world have adopted the

international accounting standards issued by the IASB.

However, global acceptance of international accounting and auditing standards need not necessarily translate into a reduction in diversity of accounting and auditing practices (IASCF, 2006). It may result in the uniformity of regulations, but it does not ensure that there will be uniformity in the application of these standards or de facto uniformity (Tay and Parker, 1990).

Environmental factors such as legal systems, sources of external finance, taxation systems, professional accounting bodies, historical inflation, economic and political events can explain international differences in accounting practices. Culture is on top of the list of factors that can influence international accounting practice and financial reporting (Nobes and Parker, 2004). Regardless of changes in government regimes, economic management styles in China the influence of culture on accounting, its basic characteristics have survived (Solas & Ayhan, 2007).

China should complete its transition to a market economy through fiscal and financial sector reforms (World Bank, 2012). The current financial reporting system of China has not satisfied the accounting information users' demand for the financial report (Dai, 2010). He highlighted three deficiencies: lacking in the relativity, lacking in the timeliness, and lacking in the reliability. The problem was echoed by (McGee & Preobragenskaya, 2003) which studied Russia's harmonization of its national accounting standard to International Financial Reporting Standards (IFRS). The conflicts in regulatory regimes, reporting standards, in addition to educational and historic differences in reporting structures between China and the developed world is a symptom of cultural difference.

This paper review existing literature on accounting sub-culture that could explain the effect of culture on the interpretations and judgments of accountants.

## II. Definition of Culture & Value

Culture ‘the collective programming of the mind which distinguishes the members of one human group from another’ (Hofstede, 1980). 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) 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.

Culture is 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 but harboured differently by each specific unit within the group, communicated across generations, relatively stable but with the potential to change across time. (Matsumoto & Juang, 2004)

Culture is, therefore, a representation of the shared values, attitudes, beliefs and behaviours among a group of people.

According to Smith and Schwartz (1997), values are a central element in the study of culture. Schwartz and Bilsky (1987) provided a conceptual definition of values as beliefs about desirable goals that guide a person’s behaviour. These goals are ordered in relative importance and transcend specific situations.

## III. Literature Review

Hofstede’s (1980) work on culture represents the most extensive research on national cultural differences to date (Doupnik & Tsakumis, 2004). Since then cross-cultural accounting studies have flourished and built on the well-known five-dimension model (Hofstede 1980; 1991; 2001).

Violet argued that accounting is a ‘socio-technological activity’ that involved interaction between both human and non-human resources (Violet, 1983). Violet claims that accounting cannot be considered culture-free.

Gray (1988) is the framework most often used to relate cultural values to accounting systems (Perera, 1989; Gerhady, 1990; Fechner and Kilgore, 1994; Baydoun and Willett, 1995). Gray argues that the value systems of accountants will be derived and related to societal values, Cultural dimension of Individualism,

- Power Distance,
- Uncertainty Avoidance and
- Masculinity

The values of accounting subculture will in turn, it is believed, impact on the development of the respective accounting systems at the national level.

According to Perera (1989), human element of accounting is influenced by environmental factors particularly culture. Perera (1989) considered both Hofstede's cultural dimensions and Gray's accounting sub cultural value dimensions and uses them to explain apparent differences in accounting practices adopted in continental European countries and Anglo-American countries. Many countries in continental

Europe are characterized by relatively high levels of uncertainty avoidance where rules or 'social codes' tend to shape behavior, while the opposite applies in Anglo-American countries.

Culture is described by Salter and Niswander (1995) as having a pervasive influence on accounting practice through the norms and values held by members of the accounting system. Different cultural groups in accounting would result in different interpretations and judgments of accounting relationships and concepts (Belkaoui & Picur, 1991). This cultural relativism of accounting (Belkaoui, 1995) would influence the consistent interpretations and judgments in the applications of accounting and auditing standards.

Zarzeski (1996) provides "evidence" that supports a view that entities located in countries classified as relatively more individualistic and masculine and relatively less in terms of UA provide greater levels of disclosure. Zarzeski also considered issues associated with international profile and found that those entities with a relatively higher

international profile tend to less secretive than other entities.

Baydoun and Willett (1995) used the Hofstede-Gray theory to investigate the use of the French United Accounting System (which was ranked lowly in terms of Professionalism and highly in terms of Uniformity as well as being considered as quite conservative) in Lebanon. However, Lebanon was considered to rank lower in terms of UA and higher in terms of Masculinity. On this basis, Baydour and Willett conclude that it would appear that Lebanon's requirements are for less Uniformity, Conservatism and Secrecy in financial reporting practices.

According to Douplik and Tsakumis (2004), accountants from different cultural groups may interpret and apply accounting and auditing standards differently even though the standards have been consistently adopted across these groups. An understanding of how culture affects the interpretations and judgments of accountants would, therefore, contribute to the efforts of reducing de facto diversity in accounting

and auditing practices.

Finch (2009) studied the impact of culture on accounting practice and financial reporting. He said "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" He suggested an empirical test to be performed using independent data on financial disclosure prepared under IFRS, as the dependent variable, against Hofstede's (1980) index score as the independent variable among IFRS jurisdictions. This research could potentially make a significant contribution toward better understanding the role and influence of culture in contemporary international accounting practice.

#### **IV. Hofstede-Gray framework**

The study of cultural relativism in accounting has relied heavily on Gray's (1988) accounting value dimensions that represent the accounting sub-culture. Gray postulated the existence of an

accounting sub-culture within the larger society. He then hypothesised a set of accounting values held by members of the accounting sub-culture that were derived from Hofstede's (1980) work-related national cultural values. 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). There is, therefore, an opportunity to explore an alternative approach to the conceptualization of the accounting sub-culture so that the influence of culture on accounting practice can be more effectively explained.

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 believes that accountants' value systems are related to and derived from the unique societal values in each country. He concluded that accounting values, affect accounting systems and cultural factors directly influence the development of accounting and financial reporting systems at a country level (Doupnik & Tsakumis, 2004).

## V. Conclusion

Gray introduced four propositions that hypothesis 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). But Gray never tested the hypothesis empirically

to support his framework. We suggest that an empirical test is performed to test the relationships between Hofstede's cultural dimensions and Gray's accounting value dimensions.

We recommend a mail survey to be carried out on accountants in China to obtain their attitudes, beliefs and opinions about their motivational goals, and their interpretations and judgments in financial reporting.

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