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International Journal of Current Research
Vol. 10, Issue, 08, pp.72488-72493, August, 2018

INTERNATIONAL JOURNAL OF CURRENT RESEARCH

ISSN: 0975-833X

RESEARCH ARTICLE

A BRIEF REVIEW OF THE CLASSIFICATION STUDIES ON THE ACCOUNTING SYSTEMS

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ARTICLE INFO

Article History:
Received 10th May, 2018
Received in revised form
24th June, 2018
Accepted 27th July, 2018
Published online 30th August, 2018

Key Words:
Accounting,
Accounting Systems,
Classification.

ABSTRACT

In this study we are trying to review the most important studies on the classification of the accounting systems, the environmental factor studies and the theoretical framework studies. The theoretical framework studies are the most recent development in comparative international accounting. The review of the major theoretical frameworks will provide a sound basis of understanding the relationship between a certain environment and its accounting system as expressed in the regulatory level or in practice. From all the selected studies we have concluded that whatever the perspective of the studies might have been, they all verify the fact that significant differences in cross-national accounting systems exist which have implication in any harmonisation attempts or in the communication of financial reports.

Citation: ***Stylianou Tasos, Athianos Stergios and Konstandinoudis Kleanthis,*** **2018.** "A brief Review of the Classification Studies on the Accounting Systems", *International Journal of Current Research*, 10, (08), 72488-72493.

INTRODUCTION

Accounting systems are evolving and reflecting the environments they serve. Despite some similarities, there are at least as many accounting systems as the countries are and none of them is exactly the same with other. There are some major environmental factors that influence the development of accounting systems. In spite the fact that there is broad agreement that such factors exist, their exact impact on accounting systems and especially financial reporting systems had not been identified. There are several lines of development in the direction of understanding world-wide accounting systems. Each study has different objectives. Some were initiated by the difficulties of harmonisation, some by the need to understand the factors that generate accounting evolution and use them as a tool to predict accounting change. No matter what their objectives were, these studies provided insights into accounting systems' development and it would be very interesting to review them (Choi, and Meeh, G. 2011). Firstly, we have the classification studies which have taken a deductive and an inductive approach. The main objective of these studies was to identify differences and similarities across national accounting systems. Secondly, there are the environmental factor studies.

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DOI: https://doi.org/10.24941/ijcr.31799.08.2018

These studies were aiming at explaining the differences and similarities of accounting systems that emerged from the classification studies. Finally, the latter studies initiated the development of theoretical frameworks for the understanding of accounting practices. That is to estimate the direct or indirect impact of environmental factors to certain patterns of accounting systems. Each category of these studies adds a building block in understanding financial reporting practices both in an international and national level (Novas *et al*., 2017). The major concern of our study is on the theoretical frameworks that explain the relationship between accounting systems and their environments. Therefore, we will attempt to review the strengths and weaknesses of such models. However, we will reference and to the objectives and outcomes of the classification and the environmental factor studies. The review of these studies is aiming to identify the major factors and their impact on accounting practices at the nation specific level.

MATERIALS AND METHODS

Classification Studies: The purpose of these studies is to group countries according to the common elements and distinctive characteristics of their financial accounting systems. By identifying similarities and differences, we can gain improved understanding of accounting systems in general. Meek and Saudagaran (1990) in their review of these studies summarised their usefulness as follows:

- The countries comprising a particular group are likely to react to new circumstances in similar ways. Countries may be able to anticipate accounting problems and solutions by looking at the experience of other counties in the same group.
- Developing countries often lack the resources to develop their own accounting standards. They may be able to identify a particular cluster that can serve as amodel for the types of standards that are most appropriate for them.
- Models represent barriers to the world-wide harmonisation efforts. By revealing these models, classification studies can aid the process of harmonisation.
- Communication problems are likely to be more severe when reporting to financial statement users occurs across groups rather than within. Multinationals may want to provide additional disclosures when users of their financial statements are from countries outside their own cluster.

Doupnik and Salter (1995) noted that the primary result of these studies has been to establish on an ongoing basis the continued diversity of financial reporting practices across counties. Furthermore, they do not attempt to develop a formal theory but rather to arrive to an accurate description of what the world appears to be.

Environmental Factor Studies: In an extensive review of these studies, Meek and Saudagaran (1990) have concluded that there is a general agreement that the following environmental factors have a considerable influence on the development of accounting systems:

The legal system: This factor reflects how laws regulate behaviour and how individuals interact with and relate to the laws of the land. The major distinction is common law countries and code law countries. Nature of the relationship between business enterprises and the providers of capital: This factor is related to the source of financing. In some countries the government, in others banks or shareholders are providing financing. Furthermore, the type of financing defines the relationship between the providers of capital and the sophistication of the capital markets. All the above relationships have impact on the type of financial reporting.

Tax laws: In many countries the tax law effectively determines the accounting rules, since companies must record revenues and expenses in their accounts in order to claim them for tax purposes. In other countries, were financial accounting and tax accounting are separate, taxable profits are essentially financial accounting profits with adjustments for differences with tax laws.

Inflation levels: Inflation places a stress on historical cost accounting and affects the tendency of a country to incorporate price changes into the accounts.

Political and economic ties: Accounting technology and ideas are imported and exported. Therefore, countries with similar historical roots are bounded to have some similarities in their institutional structure and, hence, in accounting systems. In a criticism of these studies Doupnik and Salter (1995) have noted that these studies are consisted of lists of environmental factors explaining often undefined differences in financial reporting practices. However, they do not specify the weight of the factors which are influencing the accounting system or the level at which the influence is applied. However, Perera (1989) noted that the major significant outcomes of research endeavours in the analysis of accounting in different countries has been an enhanced awareness of the importance of environmental factors in the configuration of a country's accounting system. That in turn is leading to attempts to identify both the relevant environmental factors and the wayin which these factors are influencing accounting.

Theoretical Framework Studies: The most recent development in the context of comparative international accounting are the studies related to the construction of theoretical frameworks that are attempting to explain and estimate the exact relationship between accounting system and their environments. In these studies the accounting systems are examined as social systems that interact with the other systems within a certain societal environment. The work of Harrison and McKinnon (1986) is recognised essential in understanding the rationales for the existence and development of accounting. They developed a framework, as presented in the research methodology chapter, where they were concentrated to the process of change of a system that could well be a financial reporting one. The change is analysed in terms of four major elements: intrusive events, intra-system activity, trans-systems, activity, and cultural environment.

Within the model, accounting system change is the product of both the intrusion of events and the continuous interactions among the accounting system and its neighbouring systems. A change occurs as a specific system identifies an intrusion, chooses to deal with that intrusion, and produces a series of response events based on its perception of suitable reactions. The response events take place after the subject system and neigh bouring systems have made clear to each other what needs to be done and have reached an agreement on the means that are in line with their cultural background, of achieving these objectives. In the application of their model McKinnon and Harrison (1986) in the introduction and implementation of consolidated accounts in Japan they have pinpointed the importance of culture in explaining the way an accounting system operates. Culture was treated as a substantial element of the financial reporting system as expressed in the interest groups involved in the accounting regulation setting process. As the major characteristic of the Japanese culture, the mutual trust and understanding was emerged to solve any conflicts in the process of accounting regulation.

An utterly new perspective study which was trying to explain the environmental impact on accounting systems is the studyof Gray (1988). Most of the previous studies included many environmental factors apart from culture. Gray developed a model having as major environmental factor the nation's culture. The acceptance of a cultural determinism in accounting is based on the proposition that accounting is a socio-technical activity involving an interaction between human and non-human resources (Violet, 1983 in Fechner and Kilgore, 1994). However, this cultural perspective differs from the one adopted by McKinnon and Harrison (1986). Here culture is used as an expression in institutional level. Culture is supposed to influence the structure of the nation-specific environment and, in turn, accounting systems. Gray's work was based on the societal values identified by Hofstede (1984).

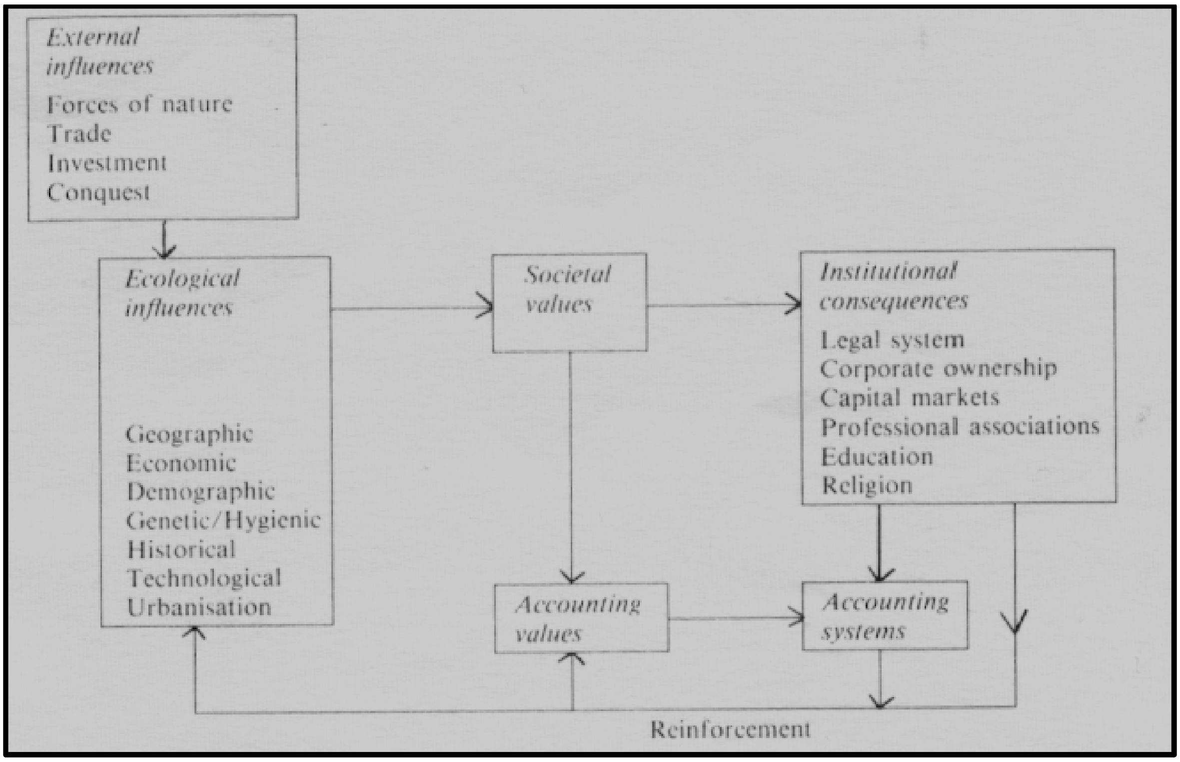
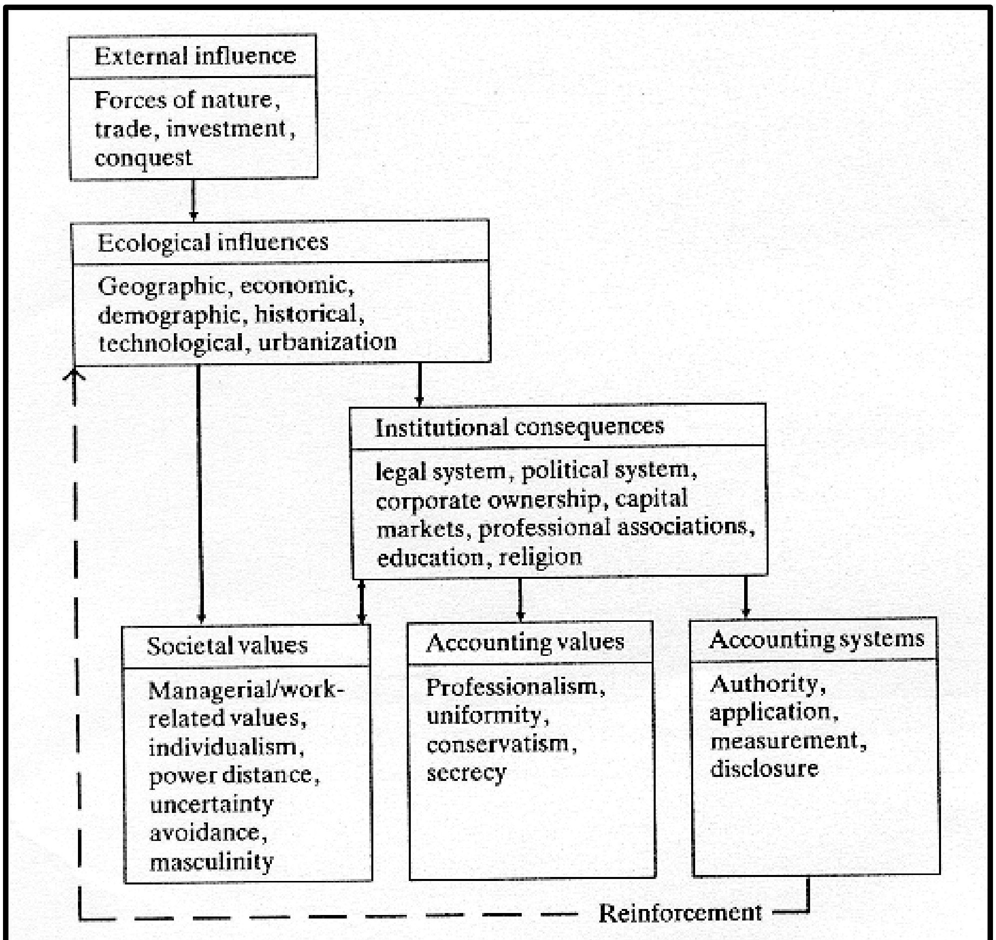
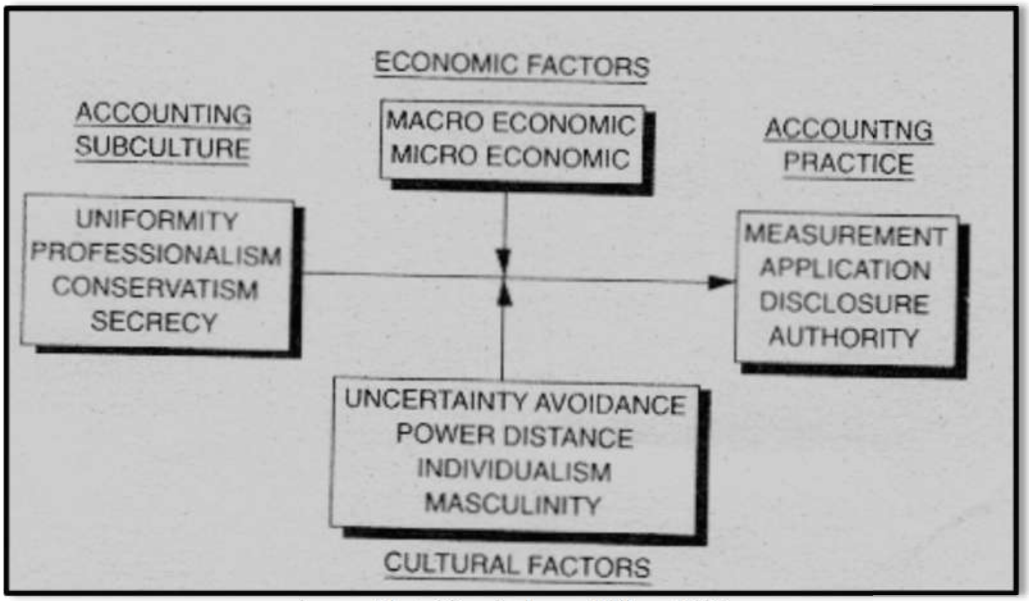


Figure 1. Culture, Societal Values, and the Accounting Sub-Culture



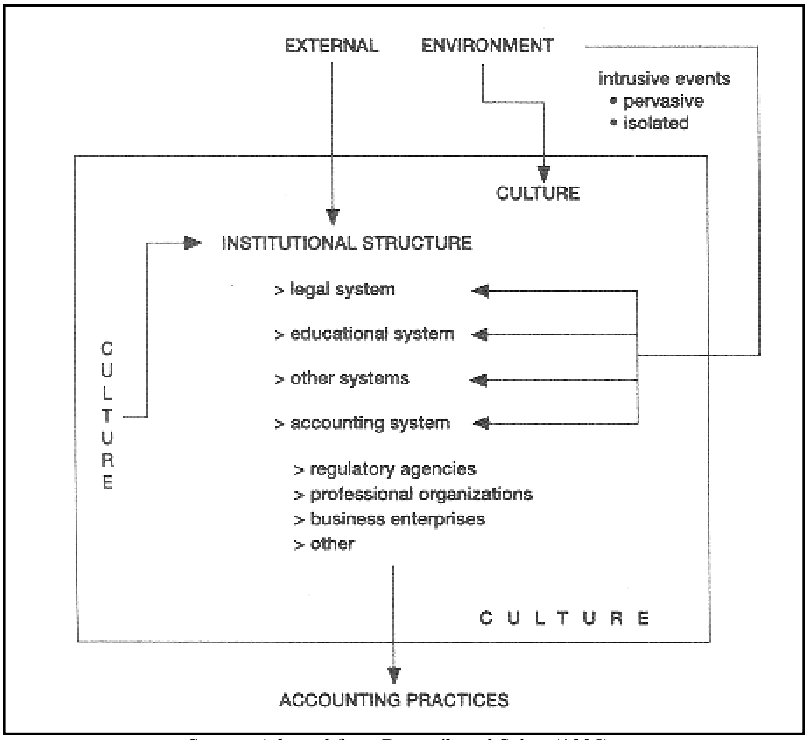
Source: Adapted from Perera (1989)

Figure 2. Accounting and Culture



Source: Adapted from Fechner and Kilgore (1994)

Figure 3. Modified theoretical framework



Source: Adapted from Doupnik and Salter (1995).

Figure 4. A general model of accounting development

These are:

- Individualism versus Collectivism –Individualism stands for a preference for a loosely knight social framework in society where individuals are supposed to take care of themselves and their immediate families only. In contrary, collectivism stands for a preference for a tightly knight social framework in society where individuals can expect their relatives, family, or others to look after them in exchange for unquestioning loyalty.
- **Large versus Small Power Distance:** Power Distance is the extent to which the members of a society accept that power in institutions and organisations is distributed unequally.
- **Strong versus Weak Uncertainty Avoidance:** Uncertainty Avoidance is the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity.
- **Masculinity versus Femininity:** Masculinity stands for a preference in society for achievement, heroism, assertiveness, and material success. In opposite, Femininity stands for a preference for relationships, modesty, caring for the weak, and the quality of life.
- Gray identified four “accounting values” and then he tried to relate them with the societal values. The accounting values were:
- **Professionalism versus Statutory Control:** A preference for the practise of individual professional

judgement and the maintenance of professional self regulation as opposed, in compliance with prescriptive legal requirements and statutory control.

- **Uniformity versus Flexibility:** A preference for the enforcement of uniform accounting practices between companies and for the consistent use of such practices over time as opposed to flexibility in accordance with the perceived circumstances of individual companies.
- **Conservatism versus Optimism:** A preference for a cautious approach to measurement so as to cope with the uncertainty of future events as opposed to a more optimistic, laissez –faire, risk – taking approach.
- **Secrecy versus Transparency:** A preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing as opposed to a more transparent, open and publicly accountable approach.

Gray's hypothesis suggests that of the four Hofstede dimensions (Hofstede *et al*., 2012), Uncertainty Avoidance and Individualism are the most influential dimensions in relation to the accounting dimensions. The interdependence of societal and accounting values as incorporated in the framework of Gray is shown in Figure 1. These accounting values are likely to influence certain aspects of accounting practice, such as the authority for accounting systems, their force of application, the measurement practices used, and the extent of information disclosed. Salter and Nishwander (1995) have tested Gray's theory and concluded that while his model based on the cultural influence on accounting practices has statistically significant explanatory power, it is best at explaining actual financial reporting practices and it is relatively weak in explaining extant professional regulatory structures from a cultural base. Furthermore, they suggested that both the development of financial markets and levels of taxation enhance the explanations offered by Gray. Based on the work of Gray (1988), Perera (1989) dealt with the impact of culture on accounting practice and developed a theoretical framework. His work was based on the relationship between societal and accounting values. He used the cultural dimensions identified by Hofstede and liked them to the accounting values identified by Gray. Then he used classification schemes and tried to explain the already identified differences using the cultural dimensions as the main explanatory variable. His model linked the accounting values to the accounting practice. In particular, the degree of professionalism preferred in an accounting subculture would influence the nature of authority for the accounting system.

The degree of uniformity preferred in an accounting subculture would have an effect on the way in which the accounting system is applied. The amount of conservatism preferred in an accounting subculture would influence the measurement practices used. The degree of secrecy preferred in an accounting subculture would influence the extent of the information disclosed in accounting reports. However, any given aspect of accounting practice may be influenced by more than one accounting value. Figure 2 encapsulates the view of his framework. A very interesting conclusion which was drawn by Pererais concerning the relationship between developed and developing countries. More specifically, he commented on the transfer of accounting skills from the developed to the developing countries. The difference in the cultural background of these countries, especially in the areas associated with the dimensions of individualism vs. collectivism and power distance, causes problems in the process of the skills transferred because they are culturally irrelevant or dysfunctional in the receiving countries' context. Fechner and Kilgore (1994) explored the relevance of environmental factors, and in particular, the influence of cultural factors on accounting systems. They concluded that both economic factors and cultural factors are influencing accounting values and accounting practice in some way. Furthermore, they suggested that the economic factor variable has a moderating influence on the association between accounting subculture values and accounting practices of measurement and application. Finally, they suggested that the cultural factor variable has a moderating influence on the association between accounting subculture values and the accounting practices of authority and disclosure. Their proposed modified framework is shown in Figure 3.

Another interesting study was that undertaken by Salter and Doupnik (1992). They used as a sole determinant of accounting systems and therefore accounting differences internationally a country's legal system. In fact, this is one of the factors that are mentioned virtually in all of the studies related to accounting practices. However, it was the work of Salter and Doupnik that established a relationship between world-wide legal systems and accounting practices. They used the work of David and Brierly (1985) on legal systems and tried to classify countries under two major categories of legal systems: Code law and Common law. Code law is European in origin and is characterised by rules of law being formulated by legal scholars based on ideas of justice and morality (Nair and Werner, 1980). On the other hand, Common law was developed primarily by judges as they resolved specific disputes. Common law legal rule seeks to provide solution to the case at hand rather than formulate a general rule of conduct for the future. The implications for accounting practices are as follows: in code law formal codification of accounting standards is found whereas accounting rules are established in a non-legalistic manner in Common law countries. The degree to which accounting rules are legislated can impact the nature of the accounting system. Meek and Saudagaran (1990) argue that in Code law countries, laws stipulate minimum requirements and accounting rules tend to be highly prescriptive and procedural. Compliance with the letter of the law is expected. On the contrary, in Common law countries, laws establish limits beyond which is illegal to venture and within those limits experimentation is encouraged and judgement is required. Within this institutional framework accounting rules tend to be more adaptive and innovative. Their test of the relationship between legal systems and accounting practices proves that a relative strong relationship does exist between legal and accounting systems.

Doupnik and Salter (1995) used parameters from various models and created a general model of accounting development. According to that general model there are three elements that appear to determine a nation's accounting development. Specifically, it is the external environment, which affects both a society's culture and its institutional structure and provides external stimuli that initiate change. Furthermore the cultural values (Nobes, 2011), which affect the institutional structure, and which govern the interactions between components of the institutional structure in evaluating suitable responses to external stimuli. Finally, the institutional structure in which within all the responses are made.

They have tested their model by using variables for each element and, specifically, they have tried to identify whether or not a relationship exists between the external environment and accounting practice, between the institutional structures and accounting practices and between cultural values and accounting practices. Their study covers a wide range of countries. However, they pointed out that case studies of individual countries would be a very interesting avenue of research. The results of their test indicated that the variables related to each of the three elements of the model were found to have significant explanatory power in discriminating across countries. Thus, the results are supporting the general model. The most important finding according to them is the importance of the legal system as a defining factor of accounting practices. These findings are in line with the work of Salter and Doupnik (1992) as mentioned above. Nobes (1998) criticised their model for the variables they used. The use of variables from both the institutional environment and cultural environment diminishes the validity of their framework. Culture as used in their model is seen as giving rise to the institutions. Therefore, there is the possibility of double counting. A related difficulty with the model is that there is no attempt to connect the institutional factors to see whether they might cause each other.

Conclusion

The above review of the studies related to comparative international accounting provides a useful guide in the attempt to understand international differences in accounting systems and explain nation-specific accounting systems and practices. Whatever their perspective might have been, they all verify the fact that significant differences in cross-national accounting systems exist which, in turn have implication in any harmonisation attempts or in the communication of financial reports. Whatever their perspective might have been all studies lend support to the influence of several factors. Even in the cultural perspective of Gray these factors are evident. However, accounting is a social science and any of these factors has different weighting and explanatory power within specific countries. This fact limits the validity of the models when trying to investigate the peculiarities of a country-specific accounting system. Furthermore, the most of the models require the collection of vast amounts of data in order to estimate the impact of the various factors.

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