

PART I: INTRODUCTION

CHAPTER 1: INTRODUCTION

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1.1 THE RESEARCH PROBLEM

Consolidation accounting policies, practices and associated disclosures in corporate annual reports vary from country to country: [see for example; Fitzgerald, Stickler and Watts (1979), Gray, Campbell and Shaw (1984), United Nations Centre on Transnational Corporations (1985), Organisation for Economic Co-operation and Development (1987), International Accounting Standards Committee (IASC)(1988), Bavishi (1989), Price Waterhouse (1991), Arthur Andersen et al (1991), BDO Binder (1991), Coopers and Lybrand (1991), and Price Waterhouse (1995)]. The association of these variations with national cultural values is investigated in this study using a contingency theory approach and multiple regression analysis. Annual reports for the 1992/93 financial years from a sample of one hundred and eighty four corporations headquartered in ten countries from the Asian-Pacific region are examined to provide evidence of the association between national cultural values and consolidation disclosure practices. The results of the multiple regression analysis provide support for the hypotheses investigated concerning the association of national cultural values and consolidation disclosure practices.

The objectives of this research are threefold. First, to provide evidence of diversity in consolidation disclosures by corporations headquartered in ten countries of the Asian-Pacific region. Second, to examine the association between national cultural values and consolidation disclosure practices in corporate annual reports. Third, to examine the association between national cultural values and the 'global fit' of consolidation disclosures by corporations in annual reports.

Financial reporting by groups of corporations is variously referred to as consolidation accounting, consolidated financial reporting, the consolidation method and group accounting [see for example; Gray, Coenenberg and Gordon, (1993)]. In this study the term consolidation accounting is used to describe the general set of accounting policies and practices used to report the activities of a group of corporations as if they were a single economic entity. The focus of the research is on the disclosures made in the corporate annual reports concerning consolidation accounting issues. The source of data is the annual report of the surveyed corporations. The use of this data source is consistent with the claim of Tay and Parker (1990, p.85) that '...actual reporting practices may be assessed most accurately from annual accounts, or detailed surveys of such accounts.'

1.2 THEORETICAL FRAMEWORK

The theoretical framework of the study is outlined in this Section. The origins of a theoretical framework for exploring international diversity in accounting practices can be traced to Mueller (1967). Other research by authors such as Previts (1975) and Radebaugh (1975) extended Mueller's descriptive approach which was concerned with identifying various social, economic and political factors that were assumed to be associated with national differences in accounting practice. However, it was not until the works of Frank (1979), Nair and Frank (1980) and Nobes (1983) that attempts were made to empirically test relationships between economic, social and other

factors and the set of accounting policies and practices adopted within a country. The division of accounting policies and practices into those concerned with measurement and disclosure in the international accounting literature was pioneered by Nair and Frank (1980).

Frank (1979) and Nair and Frank (1980) based their analysis on an inductive method. This can be contrasted with Nobes (1983) who tested an *a priori* model which classified countries according to their accounting measurement practices. The earlier analyses relied upon surveys of financial reporting practices prepared by Price Waterhouse [Fitzgerald, Stickler and Watts (1979)]. The later approach used by Nobes identified nine factors that were used to distinguish developed western countries' accounting measurement practices, and scores were assigned on a judgemental basis by the author. In none of these studies were corporate annual reports directly examined to provide evidence of diversity in either accounting measurement or disclosure practices, rather data was sourced from surveys and researcher judgement.

The distinction between examining national financial accounting rules and regulations (*de jure*) and corporate financial accounting measurement and disclosure practices (*de facto*) was argued by Tay and Parker (1990, p.74) to be significant when assessing diversity in accounting practices. Accordingly, in this study data are sourced from the annual reports of the sample of corporations surveyed. This study provides *de facto* evidence of diversity of consolidation accounting disclosure practices in respect of ten countries in the Asian-Pacific region and does not focus upon the *de jure* rules and regulations of these countries.

Understanding international accounting diversity benefited significantly from the work of Gray (1988) and his framework which related national differences to variations in national cultural values, as defined by Hofstede (1980). The framework

proposed by Gray remains only partially tested. Some papers drawing on this approach include: Karnes, Sterner, Welker and Wu (1989), Secord and Su (1989), Belkaoui (1989), Perera and Mathews (1990), Eddie (1990), Harrison (1993), Fechner and Kilgore (1994), and Baydoun and Willett (1995). This framework is reviewed in Chapter 3.

The framework pioneered by Gray (1988) has general application to understanding international diversity of accounting practices however, it has not yet been applied to the analysis of specific accounting disclosure practices. In this study aspects of Gray's theoretical framework are applied to investigate the association between national cultural values and consolidation disclosures by corporations in annual reports. The adoption of this framework is consistent with the following call by Perera (1995, p.275):

More research needs to be done in this area to identify significant relationships between accounting and culture using up-to-date information from a wide range of countries.

Economic power and wealth within most developed and developing countries are significantly controlled by individual corporations operating as part of a group of corporations, which in turn behaves as if it were a single economic entity. The capacity for groups of corporations to influence the distribution of wealth within a country is partially dependent on the cultural values of the country. This can be observed generally whereby countries tolerate different degrees of industry concentration and monopoly. Associated with this is the tolerance within countries for different levels and types of disclosures concerning the financial position and performance of a group of corporations. Therefore, it could be expected that the accounting disclosure practices of groups of corporations would be affected by and also reflect the cultural values of the country where the group is headquartered. This

study investigates the association between national cultural values and consolidation disclosures in corporate annual reports.

The framework of analysis used is a contingency approach similar to that described by the Research Methodologies Committee of the International Accounting Section of the American Accounting Association (AAA) (1993). The contingency approach used in this study is the 'contextual contingency approach', and this is discussed in Chapter 2. In this approach national cultural values are defined to be contingent environmental variables which are hypothesised to be associated with different consolidation disclosure practices in corporate annual reports.

1.3 RESEARCH METHODOLOGY

In this Section the research methodology employed in this study is outlined. This study is based on the analysis of one hundred and eighty four corporate annual reports for the 1992/3 financial years from a sample of the largest corporations headquartered in the following ten countries in the Asian-Pacific region: Australia, Hong Kong, Indonesia, Japan, (South) Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand. These countries were selected for the following reasons: First, each country has an established stock exchange requiring listed corporations to publish annual reports. Second, consolidation accounting is practised (to varying degrees) by large corporations in each country. Third, the accounting profession in each country is a member of the International Accounting Standards Committee. Fourth, national cultural values measured by Hofstede (1991) are available for these countries. Fifth, each country is a member of the Asian Pacific Economic Cooperation (APEC) group which among other objectives is encouraging corporations in the region to compete on an equal basis. Sixth, each country has been included at least once in a survey of consolidation accounting practices (see Chapter 4, Table 4.3).

The largest corporations in each country were identified from the following publications: ['Asian Company Handbook' (1991), 'Singapore 1000 Industrial' (1993), Asia Pacific Marketing Services Ltd., 'Asia's 7500 Largest Companies' (1988), Asiaweek, 'The Asiaweek 1000' (1993), Pak, J. A., 'Fortune's Pac Rim 150' (1990), and 'Business Review Weekly Top 500 Companies' (1993)]. The largest corporations were selected in the sample because these would be the ones most likely to employ consolidation accounting practices. They represent the most visible corporations from a national and international perspective for customers, investors, creditors and other annual report users. Also, the size of corporations has been shown to be significantly related to disclosure practices: [see for example, Buzby (1975), Chow and Wong-Boren (1987), Cooke (1989) and (1991a), and, Hossain, Perera and Rahman (1993)]. Selection of corporations based on their size within a country controls for a variable that has been found in prior research to be significantly related with the extent of corporate disclosure. The sample can be considered homogenous, in that each of the corporations was selected in terms of its relative size within its country of headquarters, and therefore this provides a basis for making cross-national comparisons of consolidation accounting disclosures. Details concerning the sample of corporations are reported in Chapter 7.

The corporate annual reports are examined for disclosures concerning consolidation accounting practices. Important features concerning consolidation accounting are identified from various studies on comparative national accounting measurement and disclosure practices: [for example, Fitzgerald, Stickler and Watts (1979), Gray, Campbell and Shaw (1984) United Nations Centre on Transnational Corporation (1985), Organisation for Economic Co-operation and Development (1987) Price Waterhouse (1991) and, Arthur Andersen et al (1991)]. In Chapter 6 a consolidation disclosure index is developed comprising one hundred and one items divided into ten categories. Each corporate annual report was examined for disclosures related to the items in the consolidation disclosure index. A consolidation disclosure index score

was calculated for each annual report and mean disclosure index scores are calculated for each country.

Details concerning national cultural values for the ten Asian-Pacific countries are sourced from Hofstede (1991). Hypotheses are developed concerning the association between national cultural values and the extent of consolidation disclosure and degree of variation in the extent of consolidation disclosure in corporate annual reports. Also, hypotheses are investigated concerning the association between national cultural values and the extent of 'global fit' and the degree of variation in the extent of 'global fit' of consolidation disclosures in corporate annual reports. Details concerning these hypotheses are reported in Chapter 5.

These hypotheses are tested using multiple regression analysis. Controls are introduced for the industry group and total assets of each corporation. The signs and levels of significance of the coefficients for the national cultural values in the multiple regression equations are interpreted to assess the relationship between these variables and both the extent of consolidation disclosure and also the degree of variation in the extent of consolidation disclosure in the corporate annual reports.

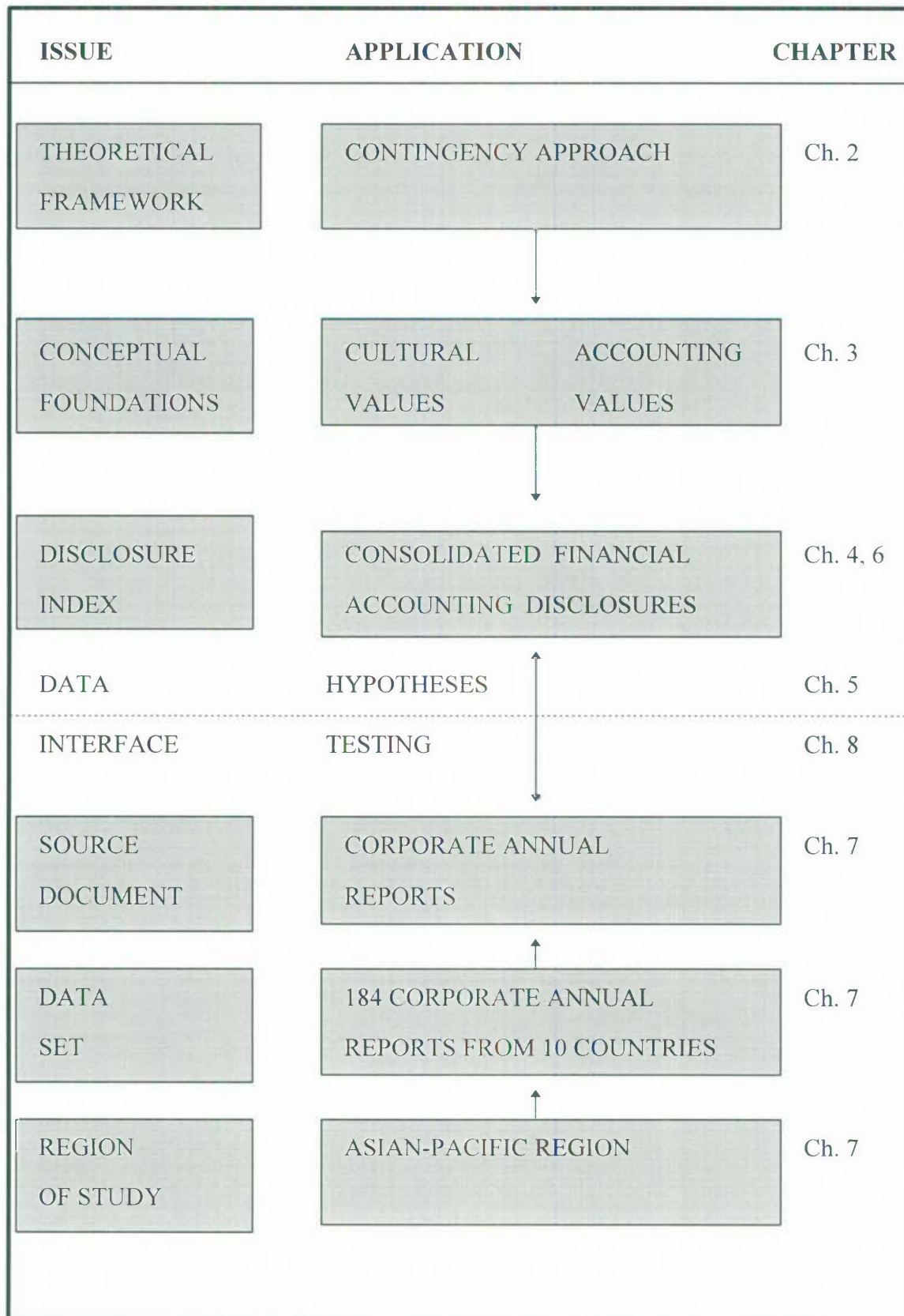
The evidence from this study is that national cultural values are significantly associated with both the extent of consolidation disclosures and the degree of variation in the extent of consolidation disclosures in corporate annual reports. Also, the extent of 'global fit' and degree of variation in the extent of 'global fit' of consolidation disclosures is found to be significantly associated with national cultural values.

1.4 OVERVIEW OF THE STUDY

This study is divided into five parts comprising nine Chapters. Part I is the introduction. Part II outlines the theoretical framework. Part III discusses the research methods. Part IV reports the results of the survey and empirical tests of the hypotheses. Part V contains the conclusions of the study.

The framework of this study is represented in Figure 1.1. The study commences by reviewing research concerned with the identification of economic, social and other environmental variables associated with national diversity of accounting principles and practices. In this study a contingency approach is adopted because this provides a general framework that is useful for studying the relationship between an event and its environment [Chapter 2]. Various models using a contingency approach are discussed and their respective application to this study is considered. The conceptual foundation of this study is based upon the ideas of national cultural values and associated accounting subcultural values as defined in the works of Hofstede (1980) and (1991), and Gray (1988) [Chapter 3]. Issues associated with consolidated financial reporting are identified from the literature [Chapter 4]. Hypotheses concerning the relationship between national cultural values and consolidation accounting disclosure practices are developed [Chapter 5]. A consolidation disclosure index for identifying and measuring disclosure of items concerning consolidation practices in corporate annual reports is developed [Chapter 6]. Data for the construction of this index is sourced from the annual reports of one hundred and eighty four corporations headquartered in ten countries of the Asian-Pacific region. A profile of the corporations surveyed and descriptive statistics concerning the sample and their respective consolidation disclosure practices are reported [Chapter 7]. Tests of the association between national cultural values and consolidation disclosure practices using multiple regression analysis are reported [Chapter 8]. Finally conclusions from the study concerning theoretical, regulatory and harmonisation issues are outlined [Chapter 9].

FIGURE 1.1: FRAMEWORK OF THE STUDY



The study comprises the following eight chapters. An outline of each of these chapters follows.

In **Chapter 2** the theoretical framework of international comparative financial accounting research, of which this study is a part, is outlined. Background information, including a review of prior research, is provided concerning the development of theoretical frameworks to study international accounting issues. The general framework adopted is based on the analyses of Wallace and Gernon (1991) and AAA (1993). In these works the contingency approach was argued to be suitable for studying cross-national diversity in accounting measurement and disclosure practices. Also, AAA (1993, p.9) argued that this approach had the potential to improve the quality of international accounting research. For the above reasons the contingency approach was selected to provide a theoretical framework for studying the association between national cultural values (the contingent environmental variables) and national variations in consolidation accounting disclosure practices.

Chapter 3 reviews various arguments concerning the relationships between national cultural values and diversity of accounting practices. The concept of national culture is located within the general contingency framework as an environmental variable. The works of Hofstede (1980) and (1991) concerning the definition and measurement of the elements of national culture are discussed. Research in the accounting literature drawing upon Hofstede's analysis is reviewed and issues associated with measuring and testing associations between national cultural values and accounting disclosure practices are considered. Finally, a descriptive contingency model of the approach adopted in this study is outlined. This model uses national cultural values as contingent variables that are hypothesised to be associated with variations in corporate consolidation disclosure practices among countries.

Chapter 4 examines the nature and diversity of consolidation accounting practices. The discussion traces the origins of consolidation accounting practice to the United States and the United Kingdom. The adoption of consolidation accounting by other countries is outlined, with particular emphasis on the ten countries that are the subject of this study. Surveys documenting evidence of international diversity in consolidation accounting practices are reviewed, again emphasising the observations concerning the ten countries in this study. Attempts to harmonise consolidation accounting practices by the IASC and the European Union are reviewed. Finally, the current documents before the Financial Accounting Standards Board (FASB) in the United States concerning consolidation accounting are discussed because of the potential impact that changes in accounting policy in the United States may have on other countries, particularly the countries that are the subject of this study.

In **Chapter 5** hypotheses are developed concerning the association of national cultural values with consolidation accounting disclosure practices. The national cultural values (high versus low power distance, strong versus weak uncertainty avoidance, individualism versus collectivism, and long term versus short term orientation) are hypothesised to be linked with consolidation disclosure practices in two ways. First, they are hypothesised to be associated with the extent of disclosure in corporate annual reports. Second, they are hypothesised to be associated with the degree of variation in the extent of disclosure in annual reports among corporations from the same country. The measures of the independent variable, national cultural values, are sourced from Hofstede (1991). The dependent variable, consolidation accounting disclosures, is measured by a consolidation disclosure index, which is discussed in Chapter 6.

Also in Chapter 5, items from the consolidation disclosure index are used to construct a 'global fit' test. Hypotheses are developed concerning the association between national cultural values and the 'global fit' of consolidation accounting disclosures in

corporate annual reports. The first hypothesis concerns the association between national cultural values and the extent of 'global fit' of disclosures in corporate annual reports. The second hypothesis concerns the association between the degree of variation in the extent of 'global fit' of disclosures in annual reports among corporations from the same country. The assessment of 'global fit' is performed using the disclosure requirements of the IASC concerning consolidation accounting as a benchmark.

Chapter 6 outlines the development of a consolidation accounting disclosure index. The use of disclosure indices in accounting research is reviewed and issues associated with the development of the consolidation disclosure index are considered. The consolidation disclosure index provides measures of the dependent variable, consolidation disclosures. One hundred and one items comprise the index and these are divided into the following ten categories:

1. Accounting policies, standards and legislation
2. Definition of the economic entity
3. Financial statements published
4. Subsidiaries and inter-entity transactions
5. Outside equity interest
6. Exclusions from consolidation
7. Goodwill
8. Treatment of goodwill
9. Associated companies
10. Joint ventures and other group arrangements

Observations in corporate annual reports of the disclosure of items comprising the consolidation disclosure index are recorded using a dichotomous scoring procedure. The results of the observations are aggregated to form a measure of disclosure for

each corporate report and divided by the maximum possible score to obtain a disclosure index score. The index scores are aggregated for all corporations from the same country and divided by the number of corporations from the country to obtain a country consolidation disclosure index score. Each corporation's consolidation disclosure index score forms the data set in the multiple regression equation which is used to test the hypothesised associations between national cultural values and consolidation disclosure practices.

In **Chapter 7** data from the survey of corporate annual reports are discussed. The following details are reported: the selection of countries in the sample; the selection of corporations in the survey; the response rate of surveyed corporations; the total assets in US dollars of each corporation; a classification of each corporation by industry; and, a classification of each corporation by country and annual report date. The measures calculated on the consolidation disclosure index for each country are reported. The between country variation in mean scores was significant at the .000 level. The magnitude of effect was calculated and it was concluded that the country of origin of the corporate annual report contributed significantly to the variability in the consolidation disclosure index scores. Also, the measures for the 'global fit' index are reported on a country basis. The between country variation in mean scores was significant at the .000 level. The magnitude of effect was calculated and it was concluded that the country of origin of the corporate annual report contributed significantly to the variability in the 'global fit' index scores. Details are reported of all corporations surveyed concerning the consolidation disclosure index in Appendix 5, and the 'global fit' index in Appendix 6.

Chapter 8 contains the results of the hypotheses testing. Multiple regression analysis using dummy variables for industry groups is used to investigate the association between national cultural values and the extent of consolidation disclosure in corporate annual reports. The square of the residuals from this multiple regression

equation is used as a dependent variable in a second multiple regression equation to test the hypotheses concerning the degree of variation in the extent of consolidation disclosure and 'global fit' in annual reports among corporations from the same country. Overall, the results indicate significant associations between national cultural values and both the extent of disclosure and the degree of variation in the extent of consolidation disclosures, and the extent of 'global fit' and the degree of variation in the extent of 'global fit' of consolidation disclosures in corporate annual reports.

In **Chapter 9** the conclusions and implications are outlined. Five conclusions are stated concerning the objectives of the study listed in Section 1.1. The evidence presented indicates consolidation disclosure practices vary significantly among the countries surveyed. The extent of consolidation disclosure and the degree of variation in the extent of consolidation disclosure in corporate annual reports is found to be significantly associated with national cultural values. Also, the extent of 'global fit' and the degree of variation in the extent of 'global fit' of consolidation disclosures is found to be significantly associated with national cultural values. Implications arising from this study are stated concerning three broad areas. First, theoretical implications concerning contingency theory and the association between national cultural values and consolidation disclosure practices are discussed. Second, implications concerning the disclosure of items relating to consolidation practices in corporate annual reports are outlined. Third, implications concerning the harmonisation of consolidation accounting practices are considered. A discussion of the limitations of the study and opportunities for further research conclude this chapter.

1.5 SUMMARY

This chapter has provided an introduction to the research problem, theoretical framework and methodology adopted. First in Section 1.1 the research problem was stated to be the investigation of the association of national cultural values with variations in consolidation disclosure practices in corporate annual reports. Data to investigate this association was sourced from one hundred and eighty four corporate annual reports from ten countries in the Asian-Pacific region.

The theoretical framework was described in Section 1.2. This study is related to previous research concerning the association of national environmental variables with corporate accounting practices. The use of *de facto* evidence of consolidation accounting disclosure practices in this study distinguishes it from previous ones. This study relies upon the concept and measurement of national cultural values reported in Hofstede (1991) and various other works. The concepts of accounting subcultural values outlined in Gray (1988) and Perera (1989) are used in developing hypotheses.

The research methodology adopted was outlined in Section 1.3. A consolidation disclosure index is developed to measure the extent of consolidation disclosure and the degree of variation in the extent of consolidation disclosure in corporate annual reports. Also, information concerning the 'global fit' of consolidation disclosures is measured using a 'global fit' index. Associations between national cultural values and consolidation disclosure measured by the consolidation disclosure index and the 'global fit' index are investigated.

The framework of this study was presented as Figure 1.1. A brief summary of the contents of each of the remaining eight chapters was presented in Section 1.4.