Cultural Considerations and the Implementation of IFRS: A Focus on Small and Medium Entities

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ABSTRACT Research revealed that inconsistent accounting practices are often attributable to environmental factors of which cultural differences appear to be the most significant. Prior research considered cultural dimensions in classifying and evaluating cultural differences, which has also been extended into accounting values. This enabled researchers to consider and identify relevant accounting values pertaining to specific accounting scenarios and environments. Recent research considered accounting values pertaining to the adoption of International Financial Reporting Standards. The purpose of the study is to identify the relevant accounting values when a global set of accounting standards is implemented by the SME sector. Based on a sample consisting of final-year accounting students from two different universities in South Africa and one in the UK, our results suggest that contrasting accounting values are considered necessary when adopting a global set of accounting standards by the SME sector.
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1. INTRODUCTION

The inconsistent accounting practices found in different parts of the world have historically fascinated accounting researchers over the years (Mueller 1965: 386; Lin and Wang 2001: 263; Gujarathi 2008: 95). A number of possible explanations for discrepancies in connection with accounting development, application and standard setting from different geographical areas of the world have been identified. One of these explanations is perhaps owing to the fact that accounting practices did not remain unchanged since its first application. The accounting practices described by Luca Pacioli were developed to address the reporting needs of Venetian merchants during the Italian Renaissance era (Edwards 1989: 52). Subsequent developments from different parts of the world required the discipline of accounting to adapt to additional reporting scenarios. Evidence of the influence of different levels of development on the accounting environment can also be found in recent times where developed countries find it easier to adopt International Financial Reporting Standards (IFRS) whereas developing countries find it more difficult to comply (United Nations 2008: 2).

Moreover, diverse accounting practices are not only attributable to different levels of development. Despite the fact that most of Europe consists of developed countries, individual member states of the European Union will move at different speeds to adopt IFRS (ACCA 2004: 1). Researchers, therefore, considered the influence of other environmental factors on the adoption and application of IFRS and the results often suggest that cultural differences are of significant influence (Perera 1989: 43; Garcia-Sordo and Baren 1999: 314).

Researchers have often focused on the cultural dimensions of Hofstede (1980: 25) and the accounting values by Gray (1988: 8) to evaluate cultural differences and its effect on the accounting environment. Various aspects within the accounting environment have been the subject of these studies, for example accounting students (Lindahl and Fanelli 2002: 285; Sullivan 2006: 1-13), accounting legislation and standard setting (Violet 1983: 2) and development of accounting practices (McKinnon 1986: 72-73). This study considered the impact of cultural differences between accounting students in South Africa and the United Kingdom (UK) as well as the relevant cultural dimensions and accounting values pertaining to the SME sector. The cultural dimensions of Hofstede (1980:25) were extended to the

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accounting values of Gray (1988:8). Hofstede's cultural dimensions considered in this study were i) individualism versus collectivism that relates to the relationship between the individual and the group, ii) power distance that relates to social inequality in relation to authority, iii) masculinity versus feminity that relates to the social implications of being born as a male or a female, and iv) uncertainty avoidance that relates to the ability to deal with uncertainty.

Following from the above, Gray's accounting values considered were i) professionalism versus statutory control which refers to professional judgement and self-regulation as opposed to compliance with prescriptive legal requirements and statutory control, ii) uniformity versus flexibility which refers to the enforcement of uniform and consistent accounting practices as opposed to flexibility in accordance with the perceived circumstances of individual companies, iii) conservatism versus optimism which refers to a cautious approach to accounting measurement as opposed to a more optimistic and risk-taking approach, and iv) secrecy versus transparency which refers to confidentiality and the restriction of disclosure of information as opposed to a more transparent, open and publicly accountable approach.

1.1 Defining the Research Objective and Hypothesis

When the International Accounting Standards Board (IASB) announced the IFRS for SMEs to address the reporting requirements of small and medium entities (SMEs), additional research questions emerged. The cultural dimensions and related accounting values considered important for purposes of adopting IFRS are not necessarily also applicable to the SME sector. It is not only possible that the cost of compliance with IFRS by the SME sector outweighs the benefits, but the focus of SMEs is also not necessarily on international markets and trends. The purpose of this study is, therefore, to identify the relevant cultural dimensions and related accounting values applicable to SMEs.

A key objective of the IFRS for SMEs was to develop a set of high quality, understandable and enforceable *global* standards for this sector (SAICA 2007: 4). When developing the IFRS for SMEs, the IASB considered transactions and

conditions typically encountered by SMEs with approximately 50 employees (IASB 2007: 6). The adoption and successful implementation of a global accounting standard for SMEs is however burdened by, amongst other possible factors, not only a lack of formalities but also the variety of definitions and different classification for SMEs by different countries. As a result the comparability of SMEs is not always possible.

Furthermore, cases of non-adherence to prevailing accounting standards were reported by Lin and Wang (2001: 263) as well as Chari and Narasimhan (2001: 1). We, therefore, suggest that due to the informal nature of SMEs, adherence to a *global* set of accounting standards by SMEs would even be more burdensome and less likely. Based hereupon the following hypothesis can be formulated:

H1: The accounting values considered to be important in the process of adopting a prescriptive global set of accounting standards may not be consistent with the accounting values required to adopt the IFRS for SMEs.

To test the above hypothesis, a survey based on Hofstede's (1980: 25) cultural dimensions and Gray's (1988: 8) accounting values were conducted amongst third year accounting students at the Mafikeng and Potchefstroom campuses of the North West University in South Africa as well as the De Montford University in the UK. The decision to include accounting students was based on the facts that i) they were expected to be one of the first groups of students to enter the working environment who were exposed to IFRS education and training, ii) the students included in our study commenced their studies approximately the same time when IFRS was introduced (Gannon and Ashwal 2004: 43), iii) they were not influenced by prior national and other non-IFRS accounting standards, practices and experiences and iv) they were generally from the same age group thus eliminating as much as possible potential 'noise' created from different age groups.

The remainder of the article is structured as follows: Section one describes the general theoretical framework and covers the relevant literature review, sections two and three present the appropriate sections, results and discussion from our study in connection with the cultural dimensions of accounting students from South Africa and the UK and the possible impact on the accounting environment, while the study concludes with the conclusion in section four.

1.2 Theoretical Framework

1.2.1 Defining Small and Medium Enterprises

SMEs are the backbone of most national economies, representing between 30 and 60 percent of the gross domestic product (Johannson 2005: 9). Furthermore, SMEs often account for 95 percent of enterprises and 60 to 70 percent of employment in most economies (Ministry of Economic Development 2005). However, Frempong (2007: 5) concluded that data on SMEs is often unreliable primarily because there is no central public database for SMEs available. Frempong (2007: 5) also emphasised the importance of defining SMEs in order to determine the economical impact of SMEs. This leads to the question of what are the organisational requirements to be considered an SME.

Etemad (2004: 1) defined Canadian SMEs as businesses with fewer than 500 employees and less than CDN$50 million in annual revenues. In Kenya and Italy, SMEs are defined as entities with less than 50 employees (ACCA 2000; Koh and Chang 2005: 384). According to Johannson (2005: 3) small and medium-sized enterprises in Canada are defined as entities having less than 100 employees. In Singapore SMEs are defined as entities with less than 200 employees (CCS 2006: 2). In the United Kingdom (UK) SMEs are defined as entities with less than 250 employees (INECE 2008: 145), in Japan SMEs are defined as entities with no more than 300 employees (Evans 1999: 1) and in the USA SMEs are defined as entities with less than 500 employees (Beyene 2002: 133). The definition of SMEs according to the European Commission recommendation 2003/361/EC is based on the number of employees which is as follows (OECD 2004: 11):

§   Micro enterprises/entities: Less than ten employees;

§   Small enterprises: Less than 50 employees; and

§   Medium enterprises: Less than 250 employees.

Furthermore, the Organisation for Economic Co-operation and Development admitted that very different practices are used across countries and over time to define SMEs (OECD 2004: 10). Some countries tend not to make a distinction between legal and statistical definitions, for example, Greece, Portugal, Mexico and the Slovak Republic. The definition can be based on a threshold in revenue, it can be based on the number of employees or it can combine the number of employees and turnover for legal and statistical purposes. Although there is no universally accepted definition of SMEs in Africa (Beyene 2002: 133), the private sector consists of mostly informal micro-enterprises, operating alongside large firms (Kauffmann 2005: 2). In the Congo, 83 percent of entities are in the informal sector and approximately 80 percent of all entities have fewer than five workers (Kauffmann 2005: 5). Due to the very small nature of SMEs in Africa (often less than 5 employees), a typical SME in the USA (with a maximum of 499 employees) might therefore be classified as a large entity in the African context (Beyene 2002: 133). In South Africa the definition of an SME is based on a combination of revenue, number of employees as well as total gross asset values. Moreover, the classification of a SMEs in the South African context is dependent on various business sectors, for example agriculture, manufacturing and construction (South Africa 2003).

None of the above definitions was necessarily the intended group of entities envisaged by the IASB in developing the IFRS for SMEs. Instead the exposure draft might have been intended for use by small and medium-sized entities that i) do not have public accountability and ii) do not publish general purpose financial statements for external users (IASB 2007: 15). In 2006, the German Accounting Standards Board (GASB) commented to the IASB that the intended group would comprise entities of different legal forms and entities of very different sizes (GASB 2006: 1). In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and conditions typically encountered by SMEs with approximately 50 employees (IASB 2007: 6). In Germany, however, the IFRS for SMEs could be too burdensome for certain companies with less than 50 employees (GASB 2006: 1).

Even though the IASB (2007: 13) concluded that the final decision on which entities are to apply IFRS for SMEs rests with national regulatory authorities and standard-setters, we suggest that the adoption of a global set of accounting standards for SMEs would be problematic due to the various definitions and classifications of SMEs by different countries.

1.2.2 The Absence of Formality

A key characteristic of SMEs is listed as a lack of formality in terms of business licenses, tax

registration, formal businesses premises and accounting procedures (South Africa 1995: 11). The American Heritage Dictionary of the English Language (2000: 494) defines the term formality as a rigorous or ceremonious adherence to established forms, rules, or customs. Frempong (2007: 7-8) emphasised the importance of distinguishing between formal and informal entities when he developed a formality index for African SMEs. His formality index is based upon i) form of ownership, ii) registration for income tax and VAT, iii) whether a business uses written employment contracts, and iv) separation of business and personal finances and book-keeping.

According to Stanworth and Curran (1976: 95), SMEs are entirely different social and economic entities than larger organisations. McKiernan and Morris (1994: 32) list the central role of the owner (CEO) as his/her multiplicity of duties and close identity with employees, inherent flexibility/ mobility, marriage of ownership/control, and nepotism/inter-family rivalry as unique SME attributes. They also argue that the imposition of formality, no matter how flexible, is incongruous with the dominant culture of SMEs and that formal mechanisms may restrict entrepreneurial flair. It is, therefore, evident that based on the definition by the American Heritage Dictionary of the English Language (2000: 494), SMEs do not formally adhere to, or follow rigorous ceremonies and processes relating to accounting procedures (South Africa 1995: 11) and bookkeeping (Frempong 2007: 7-8).

1.2.3 Reporting Framework for SMEs

Notwithstanding reports in connection with discrepancies relating to the implementation of global accounting standards by large/corporate companies, the IASB published an Exposure Draft on IFRS for SMEs in 2007. The proposed IFRS for SMEs' reporting framework is expected to be easier to apply in practice and should provide relief from many of the historic GAAP disclosure requirements (Temkin 2007: 1). The feasibility of a global set of accounting standards for the SME

sector is, however, uncertain as the traditional focus of SMEs is on local markets/environments with limited exposure to international investors and other users of SME financial statements (Johnson and Turner 2003: 128). The local markets and specific environments in which SMEs operate should, therefore, be considered prior to the adoption of a global set of accounting standards for SMEs. Furthermore, due to the fact that culture is considered to be the most important environmental factor (Perera 1989: 43), we suggest that the

SME sector is particularly vulnerable to and affected by cultural differences. The adoption of a single global set of accounting standards for the SME sector in different countries might therefore be easier said than done (Chen et al. 2002: 183; Fisher 2005: 66).

2. THE IMPACT OF CULTURAL DIFFERENCES ON ACCOUNTING STUDENTS

2.1 Hofstede's Cultural Dimensions

Our research utilised the Value Survey Model of Hofstede (1994) to evaluate cultural differences of accounting students with traditionally different cultural backgrounds. Two campuses from the North West University in South Africa were included in the sample, the Potchefstroom Campus (PTC) with predominantly white students and the Mafikeng Campus (MFK) with predominantly black students from historically disadvantaged backgrounds. In addition to accounting students from the North-West University, we have also included accounting students from the De Montfort University (DMU) in the United Kingdom. Our evaluation revealed a distinct pattern between cultural backgrounds of accounting students and the extent to which certain cultural dimensions are favoured by them. The cultural dimensions of accounting students at MFK and PTC in South Africa and the DMU in the United Kingdom are set out in table 1 after which the sample statistics and frequency of responses is presented in Table 2.

Table 1: Index rating: Cultural dimensions of accounting students

	De Montford (DMU)- UK	Potchefstoom (PTC) – SA	Mafikeng (MFK) - SA
Individualism (IDV)	78.91	77.46	59.51
Power distance (PDI)	11.68	20.97	24.89
Masculinity vs Femininity (MAS)	21.09	53.22	14.95
Uncertainty avoidance (UAI)	59.95	69.07	88.57

2.2 Gray's Accounting Values

Gray (1988: 5-8) suggested that accounting values are derived from cultural dimensions and that these accounting values, in turn, influence accounting systems. Gray also identified an interaction between his accounting values and the cultural dimensions of Hofstede. This interaction resulted in the following hypotheses (Gray 1988: 8-11):
§ The higher a group ranks in terms of *individualism* and the lower it ranks in terms of *uncertainty avoidance* and *power distance*, the more likely it is to rank highly in terms of *professionalism*.
§ The higher a group ranks in terms of *uncertainty avoidance* and *power distance* and the lower it ranks in terms of *individualism* then the more likely it is to rank highly in terms of *uniformity*.
§ The higher a group ranks in terms of *uncertainty avoidance* and the lower it ranks in terms of *individualism* and *masculinity* then the more likely it is to rank highly in terms of *conservatism*.
§ The higher a group ranks in terms of *uncertainty avoidance* and *power distance* and the lower it ranks in terms of *individualism* and *masculinity* then the more likely it is to rank highly in terms of *secrecy*.

2.3 Application of Accounting Values to Global Reporting Standards

In order to implement a *prescriptive* global set of accounting standards, we suggest that the following accounting values of Gray should be present:
§ *Statutory Control* in order to adhere to a single set of prescribed rules and regulations in connection with accounting transactions and related disclosure thereof;
§ *Uniformity* in order to, irrespective of different backgrounds, apply uniform accounting practices and principles; and
§ *Transparency* in order to be open and publicly accountable.
The adoption of a *prescriptive* global set of accounting standards is further complicated by the fact that IFRS is principles-based as opposed to rules-based, implying that the following accounting values are important:
§ *Professionalism* in order to apply professional judgment to specific scenarios;

§ *Flexibility* in order to adapt to individual situations and specific scenarios; and
§ *Transparency* for purposes of public accountability.

2.4 Application of Accounting Values to the SME Sector

We suggested that *statutory control* is the first accounting value required to adopt a global set of accounting standards. We based our conclusion on the fact that adherence to standardised accounting practices by accountants with various backgrounds will require prescriptive rules and regulations to account for a wide range of transactions. If the SME sector is added to the equation alternative accounting values might be of relevance. Legislation is not always designed to address the specific needs of the SME sector. Singh et al. (2010: 56) listed unsupportive legislation as one of the major obstacles of the SME sector. Schmidt et al. (2006: 257) argued that compliance with legislation is regarded by the SME sector as a technical matter and suggested that imposed legislation often results in negative perceptions by SME owners. Research by Munnich (2004: 3) revealed that SMEs have limited capacity to attend to legislation; as a consequence the cost of SMEs to comply with legislation is nearly six times higher than large companies. Munnich (2004: 9) also suggested that regulation reduces innovation and job creation and generally discourages entrepreneurship by SME owners. McKiernan and Morris (1994: 32) also argued that formal mechanisms may restrict the entrepreneurial flair of SMEs. The evidence therefore suggests that compliance with prescriptive legal requirements (or *statutory control*) is not an SME attribute and that *professionalism* prevail.

The second accounting value identified was *uniformity*. The opposite accounting value, *flexibility* or mobility is however listed as a key concomitant of the SME sector (McKiernan and Morris 1994: 32; McAdam 2000: 320). Hale and Cragg (1996: 16) declared that SMEs have a natural degree of *flexibility* and change orientation because of their closeness to customers and a lack of organisational bureaucracy. Pinho (2007: 728) observed that SMEs would prefer to retain *flexibility* when making business decisions. Moreover, according to Chen (2006: 145), the unique nature of SMEs is comprised of small

Table 2: Sample statistics and frequency of responses

	Campus	DMU (n=92)	PTC (n=118)	MFK (n=91)	Total (n=301)
Q1	μ	1.750	1.695	2.055	1.821
	σ	0.897	0.891	1.047	0.953
	Std. Error	0.093	0.082	0.110	0.055
Q2	μ	1.794	1.653	1.703	1.711
	σ	0.792	0.881	0.937	0.872
	Std. Error	0.083	0.081	0.098	0.050
Q3	μ	1.783	1.839	1.659	1.767
	σ	0.708	0.915	0.846	0.836
	Std. Error	0.074	0.084	0.089	0.048
Q4	μ	1.576	1.653	1.571	1.605
	σ	0.759	0.900	0.956	0.876
	Std. Error	0.079	0.083	0.100	0.051
Q5	μ	1.761	1.788	1.637	1.734
	σ	0.732	0.932	0.837	0.846
	Std. Error	0.076	0.086	0.088	0.049
Q6	μ	2.120	2.212	2.209	2.183
	σ	0.862	0.856	0.863	0.858
	Std. Error	0.090	0.079	0.091	0.050
Q7	μ	1.511	1.534	1.626	1.555
	σ	0.687	0.844	1.007	0.853
	Std. Error	0.071	0.078	0.106	0.049
Q8	μ	1.957	2.017	2.011	1.997
	σ	0.901	0.887	1.038	0.936
	Std. Error	0.094	0.082	0.109	0.054
Q9	μ	1.707	1.585	1.747	1.671
	σ	0.871	0.880	1.060	0.935
	Std. Error	0.091	0.081	0.111	0.054
Q10	μ	2.337	2.119	2.429	2.279
	σ	0.829	0.730	0.921	0.830
	Std. Error	0.086	0.067	0.097	0.048
Q11	μ	2.054	1.788	1.835	1.884
	σ	0.843	0.761	0.992	0.866
	Std. Error	0.088	0.070	0.104	0.050
Q12	μ	2.207	2.195	2.473	2.282
	σ	0.989	0.972	1.068	1.012
	Std. Error	0.103	0.090	0.112	0.058
Q13	μ	2.630	2.839	2.868	2.784
	σ	0.911	0.795	0.636	0.794
	Std. Error	0.095	0.073	0.067	0.046
Q14	μ	3.152	3.212	3.286	3.216
	σ	0.864	0.904	1.003	0.922
	Std. Error	0.090	0.083	0.105	0.053
Q15	μ	3.163	3.441	3.846	3.478
	σ	0.987	0.882	0.930	0.965
	Std. Error	0.103	0.081	0.098	0.056
Q16	μ	3.033	3.136	3.451	3.199
	σ	1.063	0.969	1.195	1.080
	Std. Error	0.111	0.089	0.125	0.062
Q17	μ	2.946	2.619	2.824	2.781
	σ	0.918	1.053	1.198	1.067
	Std. Error	0.096	0.097	0.126	0.062
Q18	μ	2.826	2.932	2.714	2.834
	σ	1.075	0.985	1.259	1.101
	Std. Error	0.112	0.091	0.132	0.064
Q19	μ	3.011	2.534	2.429	2.648
	σ	1.084	1.027	1.222	1.129
	Std. Error	0.113	0.095	0.128	0.065
Q20	μ	3.109	2.746	3.253	3.010
	σ	1.172	1.031	1.270	1.168
	Std. Error	0.122	0.095	0.133	0.067

investments, fast yields, flexible operation and the ability to swiftly adapt to market changes. We, therefore, suggest that *uniformity* is also not an SME attribute.

Thirdly, *transparency* was considered to be a prerequisite for the successful adoption of a global set of accounting standards. Edwards and Turnbull (1994: 7) suggested however that a culture of *secrecy* is often experienced by researchers when analysing financial data of SMEs. The study of Fahed-Sreih (2009: 54) was also complicated by confidentiality and *secrecy* issues when analysing revenue generated by the SME sector. Moreover, the fact that SME financial statements are only available to a limited user audience (SAICA 2000: 4) implies that SMEs would opt for *secrecy* or a preference for confidentiality. It is, therefore, evident that the third and final accounting value is also not applicable to the SME sector.

2.5 Classification of Accounting Values per Institution

Based on the above hypotheses by Gray and the aforementioned discussion the classification of accounting values of the accounting students included in the survey is presented in Figure 1.

3. DISCUSSION

The cultural dimensions in Table 1 revealed an almost perfect linear order between the three institutions included in our study (except for *masculinity*). DMU and MFK obtained highest/lowest scores for three out of the four cultural dimensions with PTC in between. Due to the fact that Gray (1988: 11) suggested that *masculinity* is of lesser importance, it was possible to convert the cultural dimensions of Hofstede in Table 1 into the accounting values of Gray in Figure 1.

The results in Figure 1 revealed that two of the three accounting values considered to be important when adopting *prescriptive* global accounting standards were favoured by MFK, namely *statutory control* and *uniformity*. The adoption of a *prescriptive* global set of accounting standards is however complicated by the fact that IFRS is principles-based as opposed to *prescriptive* rules. The results in Figure 1 suggest that none of these accounting values were favoured at MFK and that the application of principles, as opposed to rigid rules, is more acceptable to students at DMU. The adoption of a *prescriptive* global set of accounting standards is however not only complicated by the impact of principles and other factors might also play a role when a one size fits all set of accounting standards is adopted.

Where the SME sector is concerned the results in Figure 1 revealed that two out of three accounting values considered relevant to SMEs were present at DMU, namely *professionalism* and *flexibility*.
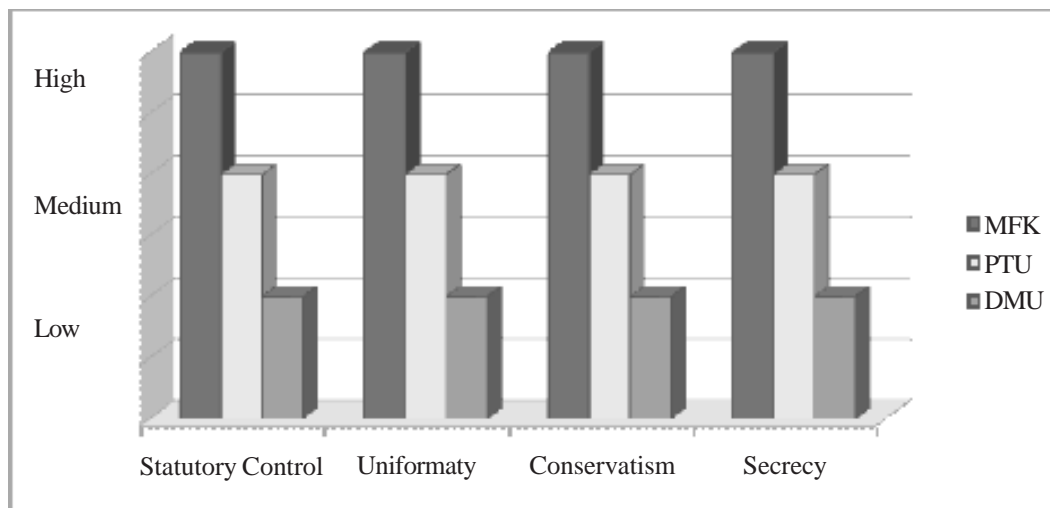

Fig. 1. Classification of accounting values

4. CONCLUSION

In conclusion, the study proposes that South African accounting students have the majority of the accounting value attributes (*statutory control* and *uniformity)* considered necessary to adopt a global set of accounting standards. The institutions included in the study were classified in order of importance as: MFK (SA), PTC (SA) and DMU (UK).

If the unique nature of the SME sector is considered, a different set of accounting values are considered to be important. The hypothesis is therefore not rejected due to the outwardly perfect negative relation between the accounting values considered to be important when adopting a global set of accounting standards (*statutory control, uniformity* and *transparency)* and the accounting values identified for the SME sector (*professionalism, flexibility* and *secrecy)*. It is, therefore, evident that the accounting students from the UK are better equipped to deal with the unique nature of SMEs due to a preference for *professionalism* and *flexibility* at DMU. Where SME-attributes are concerned the institutions included in the study should therefore be classified in the order: 1st DMU (UK); 2nd PTC (SA) and 3rd MFK (SA).

Although it appears as if South African students, and more specifically MFK students, are better equipped to adopt a global set of accounting standards and that UK students are better equipped to identify with the unique nature of SMEs, we recommend that educators, practitioners and standard setters should consider the contrasting emphasis when applying IFRS principles to the SME sector.

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