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IMPACTO DE LA CULTURA EN LA GESTIÓN DE LOS RESULTADOS: UN ANÁLISIS CON SEIS DIMENSIONES CULTURALES Y 16 PAÍSES.

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DOCTORAL THESIS

CULTURAL IMPACT ON EARNINGS MANAGEMENT:

A SIX CULTURAL DIMENSIONS AND 16 COUNTRIES ANALYSIS.

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CULTURAL IMPACT ON EARNINGS MANAGEMENT:

A SIX CULTURAL DIMENSIONS AND 16 COUNTRIES ANALYSIS.

Introduction

Globalisation has meant investors now look for better opportunities anywhere in the world, but their protection may be stronger / weaker depending on issues that affect the accounting quality of the specific country they choose to deal with.

Realising the way companies deal with earnings disclosure has faced abundant challenges, mainly since early ’90s when Arthur Levitt –then-Security & Exchange Commission Chairman– targeted the practice for enforcement.

Recent academic research by Dichev *et al*. (2013), polling nearly 170 CFOs of U.S. public companies, confirms earnings are still managed where more than 99 percent of those CFOs agreed that, at least, some companies find some room to report earnings management that misrepresent the economic performance of the company. Additionally, it revealed 40 percent said they believe the figure is greater than 15 percent; nearly half of CFOs believe that less than 10 percent of earnings per share are typically managed, but 23 percent believe more than 10 percent of EPS is managed.

Top management manipulates earnings in an attempt to influence stock price; to avoid adverse compensation and career consequences for senior executives or due to some other issues widely analysed since long time ago.

Even where reporting discretion has diminished considerably, there is a strong feeling now that International Financial Reporting Standards (IFRS) have hardened into a compliance exercise, rather than acting towards innovation and fair competition in an international context and within the investor protection focus. Main reason is there is still no concrete answer about the opportunities and constraints managers trade off to choose one set of earnings attributes over the other; a choice that is definitely affected by the economic, politic, social, legal and cultural environment.

Taking above mentioned five factors into consideration in a single research project might not be advisable, but paying special attention to those which determine strategies as well as regulations to be satisfied in different countries easily stands out the last two: legal and culture.

It is then advisable to link culture and legal topics, which support accounting facts, as the most important ones and that is why these two issues are the major focus in this thesis.

Firstly, because most of the times –due to a greater diversity of cultures and regulations to be considered in a complex decision-making environment– culture, with its own particularities for each country, demands reliable dimensions to synthesise its major distinguishing aspects.

Once those dimensions are identified, those provide an alternative to conceptualise and measure culture as a complex multidimensional structure, rather than as a simple categorical variable (Soares *et al*., 2007).

Moreover, it has been defined (Healy & Wahlen, 1999, p. 368) that "earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers."

So, if we agree main interest should be to achieve internationally comparable and high quality financial statements (Nazh, 2011), a useful help for accounting standards setters, regulators and users of financial information depends, to an important scale, on understanding cultures and how they affect earnings management.

For the above mentioned reasons, studies on cultural values continue to show prominence in research (Bergiel *et al*., 2012), most of it based on the framework attributed to Geert Hofstede's 1980 publication *Culture's Consequences: International Differences in Work Related Values* where four original cultural dimensions were analysed, research which is increasing exponentially (Taras *et al*., 2010).

In second instance, it has always been complicated to understand companies' performance when financial information originates in different geographic locations and even with the adoption nowadays, by many nations all over the world, of harmonised accounting reporting rules –as a requisite for listed firms or just a permit for many others– the specific cultural attributes of individual countries on successful adoption and implementation of IFRS is worthy to be assessed.

Even a few years after the International Accounting Standards issued between 1973 and 2001 were considered an attractive concept to harmonise accounting, first in Europe and later around the world, researchers worried about those obstacles financial analysis, at international level, will have to overcome the uncertainty which the financial analyst was used to handle.

They realised that the different accounting standards were one of those handicaps, so the question was whether the IAS would be a solution and there were interesting hypothesis among them, first, that accounting diversity is not what introduces the most important uncertainty in the international financial analysis, and second, that accounting diversity is avoided instead of being corrected (Martinez & Ortiz, 2004).

Just five years later, there was evidence that companies, in some countries, "*struggle with cultural aversion to disclosure*", as reported by the New Zealand Securities Commission Chair (Diplock, 2009), whose particular examples included a company that used the same economic growth assumptions in three completely different markets as well as the inclusion of property revaluations in property trust accounts without adequate explanation of valuation metrics and process. Diplock (2009) considered IFRS intentions to provide investors with information supporting what the management's thinking is, its core suppositions to run the company and the way to value related things is not an easy transition for everyone.

Under IFRS, companies should no longer be issuing forecasts which contain no information about the underlying assumptions that drive the top line numbers; nor should asset revaluations or impairments be stated without explaining valuation methodology and underlying assumptions about the economic conditions driving a conclusion.

So removing many allowable accounting alternatives should limit management´s discretion to manipulate earnings and help understanding whether the report is being balanced or widely optimistic, but the way to do it is directly related to the prevailing culture in the firms and the way they had been used to follow accounting rules.

It has been said that adopting IFRS aims to improve cross-country comparability of financial information, lower cost of capital and increase market liquidity, through increased uniformity in financial reporting organised around the principles-based IFRS system.

But the significantly greater consistency in accounting recognition and measurement and a greater disclosure on information in financial statements have been considered as an important burden impacting directly upon the previous reporting practices in companies.

Also, the cultural influence of corporate governance on the strength of the investor protection cannot be neglected, but differences among different geographical areas should be analysed.

Palacios-Manzano & Martinez-Conesa (2014), investigated several issues of Mexican versus US accounting standards, within the pre and post adaptation to IFRS 1997-2008 periods, and found adaptation did not lead to a decrease in earning management and that the choice of accounting method could be driven by opportunistic behaviour of managers. They also found firms applying standards adapted to IFRS showed more earnings convergence than those applying domestic standards and that efforts to converge accounting standards have increased comparability of accounting earnings, reinforcing findings in other studies.

Additionally, Palacios-Manzano *et al*. (2014) examined companies reporting under Mexican domestic standards during 1997-2005 and under “standards adapted to IFRS” during 2006-2009 to determine whether earnings quality of Mexican firms that cross-listed in the US market improved as a country’s investor protection environment becomes stronger. Results evidence such companies gradually changed their accounting reporting behaviour, presumably because the American market is more demanding in terms of information quality and transparency and quite different from the Mexican legal framework, based on the civil law tradition, where there is no procedure for class action or shareholder derivative lawsuits so it is difficult for minority shareholders to enforce their rights against management, directors or controlling shareholders.

Compliance with IFRS and impairment disclosures were analysed by Amiraslani *et al.* (2013), within a sample of listed companies across Europe during 2010-2011, and their results suggest uneven application across European countries. One of the key findings of that research states that high quality impairment reporting is more likely to be found in companies that operate in countries with a stronger regulatory and institutional infrastructure; in contrast, impairment disclosures appear to be of lower quality in countries where regulatory scrutiny is weaker.

Similar conclusions relate to earnings management in the European Union, when comparing discretionary accruals in the periods preceding and immediately after the regulatory change to determine which firms' features and country factors explained the accounting discretion observed for non-financial companies listed on 11 EU stock markets. Comparison showed earnings management has intensified since the adoption of IFRS, using business size, leverage, investor protection and legal enforcement variables (Callao & Jarne, 2010).

Additionally, Deloitte's IFRS Global Office has submitted a letter of comment, responding to the European Financial Reporting Advisory Group (*EFRAG*) Discussion Paper (*DP*) questioning whether the articulation of the recommended disclosure framework –with no significant changes to the information currently required in the notes– would satisfy the objective related to moving accounting standards towards more principles-based oriented ones.

They consider *EFRAG DP* relies more on the judgement of those preparing financial statements, instead of fulfilling IASB and IAASB responsibilities to clearly define relevance and materiality, in an acceptable way for stakeholders, users, auditors and regulators, on the context of disclosures to provide preparers with more detailed and robust guidance which might derive in more appropriate disclosures.

It is important to state that research and debate on the topic of culture and its relationship to accounting has existed after 1980, mainly based on the first work published by Geert Hofstede (Hofstede, 1980) where he detailed four cultural dimensions: Power Distance Index (PDI); Individualism vs. Collectivism (IDV); Masculinity vs. Femininity (MAS) and Uncertainty Avoidance Index (UAI).

A subsequent work by Gray (1988), eight years later, offered a hypothetical set of relationships between Hofstede's dimensions and his own culturally derived accounting value dimensions.

In addition, later works by Hofstede & Bond (1988) delivered a fifth cultural dimension, originally named Confucian Dynamism, later called Long Term Orientation (LTO) and nowadays referred to as Pragmatic vs. Normative (PRA) while Hofstede *et al*. (2010) included a sixth cultural dimension, the most recent one called Indulgence vs. Restraint (IVR), now covering sixty six countries (Borker, 2012).

In the revised edition of Hofstede *et al*. (2010), they have expanded the coverage of examined countries and structured it around the first five cultural dimensions, which is quite an important issue for this current research as it included the long / short term orientation which definitely impacts on the earnings management reasoning and, logically, was not available when Gray (1988) developed his accounting values dimensions.

A similar main issue, derived from the sixth cultural dimension, makes it advisable for this research to focus mainly on this century's research in order to assess the way those six factors contribute to earnings management.

Investigating on the best ways to improve new global accounting principles helps identifying benefits and risks, phases and implications in the wide spectrum covered by culture and legal systems and it is advisable –for a thesis like this one– to narrow the scope to a key specific variable, while preparing the field for further research and contributions: The way culture impacts on earnings management in different countries.

Therefore, this thesis attempts to contribute to theory building, in first instance, by introducing an updated Hofstede / Gray Model, with proper description and explanation, in a way researchers, standard setters, companies and all kind of financial information users alike may enhance existing knowledge about these topics.

Secondly, it aims to contribute on identifying cultural variables and legal systems, among specific countries, in their ways to deal with earnings management.

In order to support this thesis effort towards a better understanding on how earnings management, culture and legal systems relate to each other, and given the relative newness of this approach and of the fifth (PRA) and sixth (IVR) cultural dimensions, this thesis takes into consideration the scores for Hofstede's six cultural dimensions, obtained from the Dimension Data Matrix and analysed according to the Values Survey Model manual, VSM 08 updated in 2010.

It analyses, as well, different legal systems, accounting systems and subsystems, corporate governance and investor protection issues operating internationally.

The complete analysis shall help to better understand some differences which must be taken into consideration when comparing earnings management issues in the sample of countries used in the present research.

It extends previous works which analysed only the first four cultural dimensions and earnings management but did not consider the two newest dimensions or legal issues at all.

Updating their approaches, after important issues like the subprime mortgage crisis and experiences gathered after the IFRS implementation in more countries, sounds definitely convenient as it is easy to anticipate new empirical tests might evidence at least one of the two new cultural dimensions and the legal systems traditions explain, in a more significant way, direction and magnitude for the referred related earnings management, while size and tax rates should have been affected by the previously mentioned crisis as well.

This thesis is structured in an introduction and four chapters. Chapter 1 introduces related theoretical foundation for culture, legal systems and earnings management to support some international differences among the 16 countries in the sample related to accounting subculture values, corporate governance and investor protection as well.

Chapter 2, with the empirical research design, presents the testable hypotheses for this thesis, along with their rationale on how earnings management might be affected by culture and legal systems, because previous studies showed there is a strong association between four cultural dimensions and the way a country develops accounting and legal specifications, but only few have focused on identifying the linkage among the way accruals are managed in different countries as a derivation from culture and legal systems.

So it is worthy to analyse if it is so in this thesis, and also if the legal system used in specific countries might moderate the association between the six Hofstede's dimensions and discretionary accruals.

Therefore, criteria to integrate the sample –consisting of 16 countries: 8 in Europe, 7 in Asia plus Canada; with 1,188 companies operating in 10 sectors and more than thirteen thousand observations for the period 2002 to 2013– and measurement of the variables to test, empirically, direction and magnitude of discretionary accruals in the thesis are included in this chapter with the most frequently used models in the aggregate accruals literature and the six Hofstede's cultural dimensions.

Chapter 3 presents empirical results aimed to identify patterns linking culture, legal systems and earnings management in the 16 sampled countries, using Hofstede's scores, Leuz *et al*. (2003) data as well as the two main legal systems in the world reported by La Porta *et al*. (1996) while controlling for institutional differences such as outside investor rights and legal enforcement and traditional control variables like debt to equity rate, total assets and effective tax rates.

It is expected to identify specific country-related cultural behaviours for each of the six cultural dimensions directly associated with discretionary accruals per country, per year and per legal system to try to better understand motivations for people in those countries to manage earnings and in order to anticipate how those might be affecting financial information users, then deriving implications for theory and practice.

Chapter 4 incudes final remarks, limitations and delineates suggestions for future research in the conclusions closing this thesis.

IMPACTO DE LA CULTURA EN LA GESTIÓN DE LOS RESULTADOS: UN ANÁLISIS CON SEIS DIMENSIONES CULTURALES Y 16 PAÍSES.

Introducción

La globalización ha propiciado que los inversionistas busquen ahora mejores oportunidades en cualquier parte del mundo, pero su protección puede ser más fuerte o débil en función de aspectos que afectan la calidad de la contabilidad del país específico con el que decidan operar.

Comprender la manera en que las compañías atienden la divulgación de resultados ha enfrentado retos abundantes, principalmente desde inicios de los '90s cuando Arthur Levitt –el entonces Presidente de la Comisión de Valores Bursátiles– puso tal práctica en la mira para su observancia.

Una investigación académica reciente de Dichev *et al*. (2013), tras entrevistar a cerca de 170 CFOs de compañías públicas en los E.U., confirmó que los resultados siguen manipulándose ya que más del 99 por ciento de dichos CFOs estuvieron de acuerdo en que, cuando menos, algunas compañías encuentran espacio para reportar la gestión de resultados que no representan apropiadamente el desempeño de la compañía. Además, reveló que 40 por ciento mencionaron que creían que la cifra es superior al 15 por ciento; cerca de la mitad de los CFOs cree que menos del 10 por ciento de los resultados por acción son típicamente manipulados, pero 23 por ciento cree que más del 10 por ciento de la UPA se manipula.

La alta dirección manipula los resultados intentando influenciar en el precio de la acción; para evitar una compensación adversa y consecuencias en la carrera de los ejecutivos más antiguos o debido a otros aspectos ampliamente analizados desde hace mucho tiempo.

Aun cuando la discrecionalidad en la divulgación ha disminuido considerablemente, existe ahora un fuerte sentimiento de que las Normas Internacionales de Información Financiera (NIIF) se han endurecido para conformar un ejercicio de cumplimiento, en vez de orientarse a la innovación y a la competencia justa en un contexto internacional y con el enfoque de protección al inversionista. La principal razón deriva de que no existe todavía una respuesta concreta sobre las oportunidades y limitaciones que los gerentes deben tomar en consideración al momento de seleccionar un conjunto de atributos de los resultados sobre otro; una elección que está definitivamente afectada por el entorno económico, político, social, legal y cultural.

Tomar los cinco factores arriba mencionados en consideración en un único proyecto de investigación no sería aconsejable, pero poner especial atención en aquellos que determinan tanto las estrategias como las regulaciones que deben satisfacerse en diferentes países fácilmente propicia que destaquen los últimos dos aspectos: legal y cultural.

Resulta entonces aconsejable vincular los temas culturales y legales, que sustentan hechos contables, como los más importantes y es por ello que esos dos aspectos son la razón de ser de esta tesis.

En primera instancia, ya que la mayoría de las veces –debido a una mayor diversidad de culturas y regulaciones que deben ser consideradas en un complejo entorno de toma de decisiones– la cultura, con sus propias particularidades para cada país, demanda dimensiones confiables para sintetizar sus aspectos distintivos más relevantes.

Una vez que tales dimensiones se han identificado, esas proporcionan una alternativa para conceptualizar y medir la cultura como una estructura compleja y multidimensional, en vez una simple variable categórica (Soares *et al*., 2007).

De hecho, se ha definido (Healy y Wahlen, 1999, p. 368) que "la gestión de los resultados ocurre cuando la gerencia usa su juicio al elaborar los reportes financieros y al estructurar transacciones para alterar los reportes financieros ya sea para engañar a algunos accionistas sobre las condiciones subyacentes del desempeño económico de la empresa o para influenciar los resultados contractuales con relación a los números contables reportados".

Así que si estamos de acuerdo en que el principal interés debería ser obtener estados financieros internacionalmente comparables y de elevada calidad (Nazh, 2011), una ayuda útil para los encargados de la elaboración de normas contables, reguladores y usuarios de la información financiera depende, en gran medida, de comprender las culturas y cómo afectan esas la gestión de los resultados.

Por las razones antes mencionadas, los estudios sobre valores culturales continúan mostrando preeminencia en la investigación (Bergiel *et al*., 2012), en su mayoría basados en el marco de referencia de la publicación C*onsecuencias de la cultura: Diferencias internacionales en los valores relacionados con el trabajo* de Geert Hofstede en 1980 en la cual se analizaron las cuatro dimensiones culturales originales), trabajos de investigación que están incrementándose exponencialmente (Taras *et al*., 2010).

En segunda instancia, siempre ha resultado complicado entender el desempeño de las empresas cuando la información financiera se origina en diferentes ubicaciones geográficas e inclusive con la adopción hoy en día, por parte de muchas naciones por todo el mundo, de normas contables armonizadas –como requisito para las empresas listadas o sólo voluntariamente para muchas otras– los atributos específicos de países individuales en la adopción exitosa de la implementación de la NIIF merecen ser evaluados.

Incluso unos años después de que las Normas Internacionales de Contabilidad emitidas entre 1973 y 2001 fueran consideradas como un concepto atractivo para armonizar la contabilidad, primero en Europa y después en el mundo, a los investigadores les preocupaban los obstáculos que los analistas financieros, a nivel internacional, tendrían para superar la incertidumbre que el analista financiero acostumbraba manejar.

Ellos se percataron que las normas contables diferentes eran uno de esos obstáculos, por lo cual la pregunta era si las NIC serían una solución y hubo interesantes hipótesis entre esas, primero, en cuanto a que la diversidad contable no es lo que introduce la principal incertidumbre en el análisis financiero internacional, y en segundo lugar, que la diversidad contable se esté evitando en vez de corrigiendo (Martínez & Ortiz, 2004).

Apenas cinco años después, hubo evidencia de que las empresas, en algunos países, "*luchan con la aversión cultural a la divulgación*", según reportó el Presidente de la Comisión de Valores de Nueva Zelanda (Diplock, 2009), cuyos ejemplos particulares incluían una compañía que usó los mismos supuestos en tres mercados totalmente diferentes así como la inclusión de revaluaciones de propiedades en cuentas de fideicomiso inmobiliario sin una adecuada explicación de la métrica de valuación ni del proceso. Diplock (2009) consideró que las intenciones de las NIIF de proporcionar a los inversionistas información que sustentara lo que es el pensamiento de la administración, sus suposiciones medulares para dirigir la empresa y la forma de valuar aspectos vinculados no es una transición sencilla para nadie.

Al amparo de la NIIF, las empresas ya no deberían emitir pronósticos que no contuvieran la información sobre los supuestos subyacentes que impulsan las principales cifras; ni las revalorizaciones de activos o pérdidas por deterioro debieran expresarse sin explicar la metodología de valuación y los supuestos subyacentes sobre las condiciones económicas que impulsan la conclusión.

De forma tal que retirar muchas alternativas contables permitidas debería limitar la discrecionalidad de la administración para manipular los resultados y ayudar a comprender si está equilibrado el informe o es muy optimista, pero la forma de hacerlo está directamente relacionada con la cultura prevaleciente en las empresas y en la forma en la que han estado acostumbradas a seguir las normas contables.

Se ha dicho que adoptar las NIIF ayuda a mejorar la comparabilidad de la información financiera entre países, disminuye el costo de capital e incrementa la liquidez del mercado, mediante la uniformidad incrementada en la divulgación financiera organizada a partir del sistema basado en principios de las NIIF.

Pero la significativamente mayor consistencia en el reconocimiento y medición contable y una mayor divulgación de información e los estados financieros ha sido considerada como una importante carga que impacta directamente en las prácticas previas de divulgación en las empresas.

De igual forma, no puede negarse la influencia del gobierno corporativo sobre la fortaleza de la protección al inversionista, pero deben analizarse las diferencias entre áreas geográficas diversas.

Palacios-Manzano y Martinez-Conesa (2014), han investigado diversas situaciones entre la normativa Mexicana contra la de los EU, durante los períodos de pre y post adaptación de las NIIF en 1997-2008 y encontraron que la adaptación no derivó en decremento en la gestión de los resultados y que la elección del método contable podría estar guiada por un comportamiento oportunista de los gerentes. Ellas también identificaron que las empresas que aplican las normas adaptadas a las NIIF mostraban mayor convergencia en los resultados que aquellas que aplican normas domésticas y que el objetivo de converger las normas contables había incrementado la comparabilidad de los resultados contables, reforzando los hallazgos de otros estudios.

Adicionalmente, Palacios-Manzano *et al.* (2014) examinaron empresas que divulgaron bajo los estándares domésticos de México durante 1997-2005 y bajo los “estándares adaptados a las NIIF” durante 2006-2009 para determinar si la calidad de los resultados de las firmas Mexicanas que cotizaban en forma cruzada en el mercado de los EU mejoraba a medida que el entorno de la protección al inversionista de país se hacía más exigente. Los resultados evidencian que las referidas empresas modificaron gradualmente su comportamiento contable de divulgación, presumiblemente porque el mercado Americano es más demandante en términos de la calidad y transparencia de la información y muy diferente al marco legal Mexicano, basado en la tradición legal civil, en el cual no existe procedimiento de demanda colectiva o juicios promovidos por accionistas de forma tal que resulta difícil para los inversionistas minoritarios hacer respetar sus derechos contra la administración, los directivos o los accionistas mayoritarios.

La observancia de las NIIF y la divulgación de pérdida por deterioro fueron analizados por Amiraslani *et al.* (2013), a partir de una muestra de compañías listadas en Europa durante 2010-2011, y sus resultados sugieren una aplicación desigual a lo largo de los países Europeos. Uno de los hallazgos clave de esa investigación indica que es más factible identificar divulgación de alta calidad sobre pérdidas por deterioro en países con infraestructura regulatoria e institucional más exigente; en contraste, la divulgación de las pérdidas por deterioro parece ser de menor calidad en países donde el escrutinio regulatorio es más débil.

Conclusiones similares se vinculan con la gestión de los resultados en la Unión Europea, cuando se comparan los devengos discrecionales en los períodos precedente e inmediatamente posterior al cambio regulatorio para determinar cuáles características de las firmas y factores del país explican la discrecionalidad contable observada en empresas no financieras listadas en 11 mercados bursátiles de la UE. La comparación evidenció que la gestión de los resultados se ha incrementado desde la adopción de las NIIF, al utilizar las variables tamaño de la empresa, apalancamiento, protección al inversionista y exigibilidad legal (Callao y Jarne, 2010).

Adicionalmente, La Oficina Global de las NIIF de Deloitte envió un comunicado con comentarios, en respuesta al Documento de Debate (DD) del Grupo Consultivo Europeo sobre Información Financiera (GCEIF) cuestionando si la articulación de la infraestructura recomendada de divulgación –que no incluye cambios significativos sobre la información que actualmente se requiere en las notas– cumpliría el objetivo relacionado con dirigir la normativa contable hacia una más basada en principios.

Ellos consideran que el DD de la CGEIF descansa más en el juicio de quienes preparan los estados financieros, en vez de satisfacer las responsabilidades del IASB y del IAASB de definir claramente la relevancia y la materialidad, en forma aceptable para partes interesadas, usuarios, auditores y reguladores, en el contexto de las divulgaciones que proporcionen a quienes preparan la información con una guía más detallada y robusta la cual podría derivar en una divulgación más apropiada.

Es importante indicar que la investigación y el debate sobre el tema de la cultura y su relación con la contabilidad ha existido después de 1980, principalmente basándose en el primer trabajo publicado por Geert Hofstede (Hofstede, 1980) en el cual detalló cuatro dimensiones culturales: el Índice de Distancia del Poder (PDI);

Individualismo vs. Colectivismo (IDV); Masculinidad vs, Feminidad (MAS) y Tendencia a Evitar la Incertidumbre (UAI).

Una investigación subsecuente elaborada por Gray (1988), ocho años después, ofreció un conjunto hipotético de relaciones entre las dimensiones de Hofstede y sus propias dimensiones culturalmente derivadas de valores contables.

Además, investigaciones posteriores por parte de Hofstede y Bond (1988) desarrollaron una quinta dimensión cultural, originalmente llamada Dinamismo de Confucio, luego llamada Orientación de Largo Plazo (LTO) y actualmente conocida como Pragmático vs. Normativo (PRA) en tanto que Hofstede *et al*. (2010) incluyeron una sexta dimensión cultural, la más reciente llamada Indulgencia vs. Restricción (IVR), que actualmente cubre sesenta y seis países (Borker, 2012).

En la edición revisada de la obra de Hofstede *et al*. (2010), ellos han expandido la cobertura de los países examinados y la estructuró con base en las cinco primeras dimensiones culturales, lo que resulta un hecho importante para la presente investigación ya que incluyó la orientación a largo / corto plazo misma que definitivamente impacta en el razonamiento para la gestión de los resultados y, lógicamente, no estaba disponible cuando Gray (1988) desarrolló sus dimensiones de valores contables.

Un suceso igualmente relevante, derivado de la sexta dimensión cultural, hace aconsejable para esta investigación enfocarse principalmente en la investigación del presente siglo a fin de evaluar la forma en que estos seis factores contribuyen a la gestión de los resultados.

Investigar sobre las mejores formas de enriquecer nuevos principios contables globales ayuda a identificar beneficios y riesgos, fases e implicaciones en el amplio espectro que abarcan la cultura y los sistemas legales y es recomendable –para una tesis como la presente– centrar el alcance, en tanto se prepara el campo para posteriores investigaciones y contribuciones, hacia una variable específica: La forma en la que la cultura impacta la gestión de los resultados en diversos países.

En consecuencia, esta tesis pretende contribuir a la construcción de teorías, en primera instancia, presentando un Modelo Hofstede / Gray actualizado, con descripción y explicación apropiadas, de forma tal que los investigadores, quienes elaboran las normas, las empresas y todo tipo de usuarios de la información financiera por igual puedan enriquecer el conocimiento existente sobre estos temas.

En segundo término, pretende contribuir a la identificación de variables culturales y sistemas legales, entre países específicos, en cuanto a las formas de hacer frente a la gestión de los resultados.

A fin de sustentar el esfuerzo de esta tesis hacia una mejor comprensión sobre cómo la gestión de los resultados, la cultura y los sistemas legales se relacionan entre sí, y dada la relativa novedad de esta perspectiva y de la quinta (PRA) y sexta (IVR) dimensiones culturales, esta tesis toma en cuenta los puntajes de Hofstede para sus seis dimensiones culturales obtenidos a partir de la Matriz de Datos de las Dimensiones y analizados con base en Modelo de Encuesta de Valores, MEV 08 actualizado al 2010.

Se analizan, de igual forma, diferentes sistemas legales, sistemas y subsistemas contables, gobierno corporativo y protección al inversionista internacionalmente.

Se espera que el análisis completo ayude a comprender mejor algunas diferencias que deben tomarse en cuenta al comparar aspectos de la gestión de los resultados en la muestra de países utilizada en la presente investigación.

Amplia investigaciones previas que analizaron únicamente las primeras cuatro dimensiones culturales conjuntamente con la gestión de los resultados pero que no consideraron las dos nuevas dimensiones y nada tampoco de los aspectos legales.

Actualizar sus perspectivas, tras sucesos importantes como la crisis de las hipotecas de alto riego y experiencias acumuladas tras implementar las NIIF en más países, parece definitivamente conveniente ya que resulta fácil anticipar que nuevas pruebas empíricas podrían evidenciar que cuando menos una de las dos nuevas dimensiones culturales y las tradiciones de los sistemas legales explican, en una forma más significativa, la dirección y magnitud de la referida gestión de los resultados, en tanto que el tamaño y las tasas de impuestos debieron resultar afectados también por las crisis antes mencionadas.

La tesis se estructura en una introducción y cuatro capítulos. El Capítulo 1 trata sobre los fundamentos teóricos de la cultura, los sistemas legales y la gestión de los resultados para sustentar algunas diferencias internacionales relacionadas con los valores de la subcultura contable, el gobierno corporativo y la protección al inversionista por igual entre los 16 países de la muestra.

El capítulo 2, con el diseño de la prueba empírica, presenta las hipótesis a probar en esta tesis, junto con sus fundamentos sobre cómo la gestión de los resultados podría resultar afectada por la cultura y los sistemas legales, debido a que estudios previos demostraron que existe una fuerte asociación entre cuatro de las dimensiones culturales y la forma en que un país desarrolla especificaciones contables y legales, pero sólo unos pocos se han enfocado en identificar el vínculo entre la forma en que se gestionan los devengos en distintos países como una derivación de la cultura y los sistemas legales.

Así que conviene analizar si es así en esta tesis y también si el sistema legal aplicado en países específicos pudiera moderar la asociación entre las seis dimensiones de Hofstede y los devengos discrecionales.

Por tanto, los criterios para integrar la muestra –consistente en 16 países: 8 en Europa, 7 en Asia más Canadá; con 1,188 empresas operando en 10 sectores y más de trece mil observaciones durante el período 2002 a 2013– y la medición de las variables para probar, empíricamente, la dirección y magnitud de los devengos discrecionales in este estudio se incluyen en el presente capítulo con los modelos más frecuentemente utilizados en la literatura sobre devengos acumulados y con las seis dimensiones culturales de Hofstede.

El Capítulo 3 presenta los resultados empíricos con los que se pretende identificar patrones que vinculen la cultura, los sistemas legales y la gestión de los resultados en los 16 países de la muestra, usando los puntajes de Hofstede, datos de Leuz *et al*. (2003) y los dos principales sistemas legales en el mundo reportados por La

Porta *et al*. (1996) controlando diferencias institucionales como los derechos del inversionista externo y la obligatoriedad legal y variables de control tradicionales como la razón de apalancamiento, el total de activos y las tasas efectivas de impuestos.

Se espera identificar comportamientos culturales asociados al país para cada una de las seis dimensiones culturales directamente con los devengos discrecionales por país, por año y por sistema legal para intentar comprender mejor las motivaciones de la gente en esos países para gestionar los resultados a fin de anticipar cómo pueden estar afectando esos a los usuarios de la información financiera, de forma tal que deriven en implicaciones para la teoría y la práctica.

El Capítulo 4 incluye observaciones finales, limitaciones y delinea sugerencias para futuras investigaciones en las conclusiones que cierran esta tesis.

CHAPTER 1

Culture and Financial Reporting Internationally

1.1. INTRODUCTION

Debate about culture has been present among sociologists and anthropologists since the 19th century and it has been widely defined in terms of some commonly shared processes, like shared ways of thinking, feeling and reacting among their members. Its definitions tend to include almost everything in the environment of human beings that is not immutably determined by nature.

According to Soares *et al*. (2007), Sir Edward B, Taylor, in what seems to be one of the first scholarly accepted definitions back in 1871, said: “Culture is that complex whole which includes knowledge, beliefs, arts, morals, law, customs, and any other capabilities and habits acquired by [a human] as a member of society.”

Definitions, at least since second half of last century (House *et al*., 1996) include mentions about a way of thinking, considering culture is “A pattern of basic assumptions –invented, discovered, or developed by a group as it learns to cope with its problems of external adaptation and internal integration– that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those processes”.

Then Hofstede (1980) anthropomorphised culture as “the collective software of the mind which distinguishes the members of one human group from another” and, according to Taras *et al*. (2010), thousands of empirical studies were inspired by his ground-breaking document and the cultural value dimensions he identified, which will be analysed later on this thesis.

In an attempt to define culture “accordingly”, some authors have focused on its pragmatism, Weberian significance, integration emphasis, structuralism, anthropological fringes, cognitive, symbolic or psychologic developments, but they all include commonalities to date, as seen throughout the previous definitions (House *et al.*, 1996):

i) Cultures are collectively oriented phenomena, referring to shared meanings, and there is awareness among the members that their interpretations are shared.

ii) Agreed-upon values and beliefs have prescriptive or proscriptive implications while cultural patterns are manifested linguistically, behaviourally, and symbolically in the form of artifacts.

iii) Common member experiences are among the most important antecedents to the development of cultural patterns, where members of collectivities identify with an agreed-upon specific set of values and common social identities.

iv) Common experiences and cultural patterns have powerful socialisation effects on the members of collectives referred to as cultures.

v) The social influence of cultural patterns provides a set of compelling affective, cognitive and behavioural, orientations for members of cultures, who are presumed to abide by the set of norms that reflect the above-mentioned commonalities.

Interesting manuscripts derived from the previous stands, some proclaimed by psychologists –like the one from Rokeach (1968)– or sociologists, like Kluckhohn (1951), focusing firstly on values as the criteria people use to select and justify actions and to evaluate people (including the self) and events.

Schwartz (1992) explored the importance of values by addressing three questions: First, how are the value priorities of individuals affected by their social experiences? And second, how do the value priorities held by individuals affect their behavioural orientations and choices?

Those two aspects had been previously studied within single cultures, but he was also concerned with the extent to which systematic associations among values, social experience, and behavioural orientations hold across cultures.

Third, his project addressed the question of cross-cultural or cross-national differences in value priorities and tried to identify some of their causes and effects and took whole cultural groups as his unit of analysis, following in the footsteps of Hofstede's (1980) monumental work.

However, he limited his analyses to dimensions of values at the individual level, which is the appropriate level for the study of the first two questions and distinguished a set of basic issues that must be resolved before the three broad questions elaborated above could be researched effectively:

a) Value content: What types of values are likely to be recognised and used to form priorities within and across all cultures? Do values form some universal set of types?

b) Does the set include all the types of values to which individuals are likely to attribute at least moderate importance as criteria of evaluation?

c) Equivalence of meaning: Do the values have the same or similar meanings among the differing groups of persons under study?

d) Value structure: Does such a value structure exist? Is it universal?

In an early version of his theory (Schwartz and Bilsky 1987), a conceptual definition of values was elaborated, one that incorporated the five formal features of values recurrently mentioned in the literature: Values (1) are concepts or beliefs, (2) pertain to desirable end states or behaviours, (3) transcend specific situations, (4) guide selection or evaluation of behaviour and events, and (5) are ordered by relative importance.

Then, after reviewing the theory, ten basic values that people in all cultures recognise were identified.

These authors discovered some values conflict with one another (e.g., benevolence and power) whereas others are compatible (e.g., conformity and security), so individuals and groups have different value “priorities” or “hierarchies”.

They specified methods for measuring universal motivational types of values, as tradition and stimulation had neither been derived fully nor studied empirically (a synthesis of main defining goals are expressed after each value):

a) Self-Direction: Independent thought and action--choosing, creating, exploring.

b) Stimulation: Excitement, novelty, and challenge in life.

c) Hedonism: Pleasure or sensuous gratification for oneself.

d) Achievement: Personal success through demonstrating competence according to social standards.

e) Power: Social status and prestige, control or dominance over people and resources.

f) Security: Safety, harmony, and stability of society, of relationships, and of self.

g) Conformity: Restraint of actions, inclinations, and impulses likely to upset or harm others and violate social expectations or norms.

h) Tradition: Respect, commitment, and acceptance of the customs and ideas that one's culture or religion provides.

i) Benevolence: Preserving and enhancing the welfare of those with whom one is in frequent personal contact (the 'in-group').

j) Universalism: Understanding, appreciation, tolerance, and protection for the welfare of all people and for nature.

Figure 1, in the following page, shows one dimension contrasts 'openness to change' and 'conservation' values. This dimension captures the conflict between values that emphasise independence of thought, action, feelings and readiness for change (self-direction, stimulation) and values that emphasise order, self-restriction, preservation of the past, and resistance to change (security, conformity, tradition).

The second dimension contrasts 'self-enhancement' and 'self-transcendence' values. This dimension captures the conflict between values that emphasise concern for the welfare and interests of others (universalism, benevolence) and values that emphasise pursuit of one's own interests and relative success and dominance over others (power, achievement). Hedonism shares elements of both openness to change and self-enhancement.

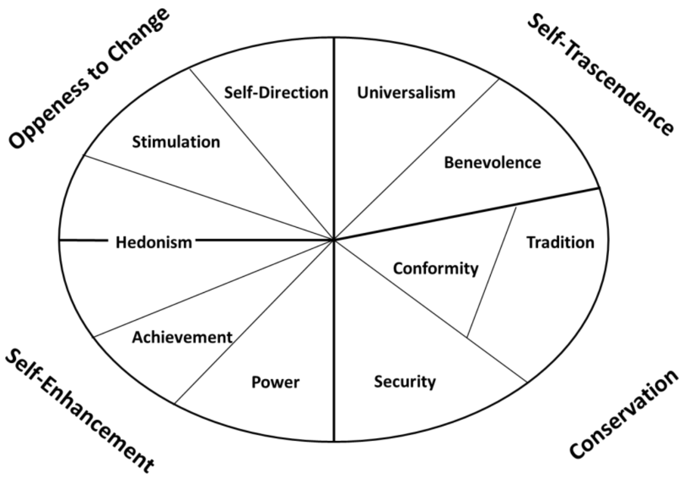

Figure 1.1 Schwartz theoretical model of relations among ten motivational types of value

Later, strong evidence for the cross-cultural theory assessed it with data from hundreds of samples in 82 countries around the world, with highly diverse geographic, cultural, linguistic, religious, age, gender, and occupational groups and, moreover, each of the ten basic values has been distinguished in at least 90% of samples.

So findings show that people in most cultures respond to ten types of values as distinct and that the broader value orientations captured by adjacent values are discriminated nearly universally.

Power, achievement and tradition were identified in all countries; hedonism, self-direction, universalism and security types in 95% of countries while stimulation, benevolence and conformity appeared in 90%.

Trompenaars and Hampden-Turner (1997, p.6) argued that there are major cultural differences between nations affecting the process of doing business, whereas in this context culture is understood as simply the way in which a group of people solves problems and reconciles dilemmas, so they defined culture as the very matrix of presuppositions, categories, concepts and values that are the basis of peoples' attempts to solve various problems that arise in day-to-day life and also in business.

Consequently people solve problems under 3 headings: those which arise from our relationships with other people; those which come from the passage of time; and those which relate to the environment and identified seven cultural dimensions, expressed as couples of opposing attitudinal dispositions that can be identified in each culture:

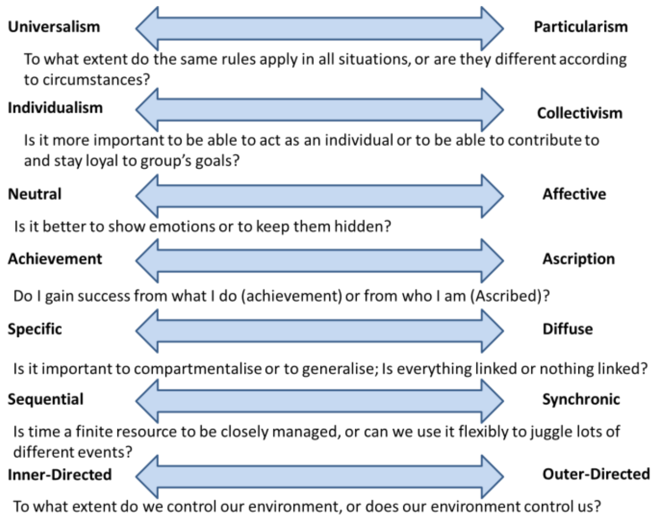

Figure 1.2 Trompenaars and Hampden-Turner's 7 Cultural Dimensions

a) Universalism vs. Particularism is the standards by which relationships are measured: Universalist societies tend to feel that general rules and obligations are the source of moral reference so they assume that their standards are the correct standards and attempt to change the attitudes of others to match theirs. Particularistic societies are those in which particular circumstances are more important than rules and therefore response to a situation may change according to the circumstances and the people involved.

b) Individualism vs. Communitarianism is about the conflict between an individual's desire and the interests of the group which they belong. In the first one, people are expected to make their own decisions and to only take care of their own needs, while in the second one the community comes before the individual, and people are mainly oriented towards common goals and objectives.

c) Specific vs. Diffuse, concerns on how people view the picture of life and the degree of involvement in relationships. People from specifically-oriented cultures analyse elements separately, then put them back together again and individuals engage others in specific areas of life, affecting single levels of personality. People from diffusely-oriented cultures see each element in the perspective of the complete picture; all elements are related to each other, while their individuals engage others diffusely in multiple areas of life, affecting several levels of personality at the same time.

d) Neutral vs. Emotional, focusing on the degree to which people express their emotions, and the interplay between reason and emotion in human relationships. In culture high on affectivity, people freely express their emotions. In a neutrally-oriented culture, people are taught that it is incorrect to overtly show feelings.

e) Achievement vs. Ascription, considers how personal status is assigned. That means the firstly mentioned kind of societies accord status to people on the basis of their performance, where the second ones attribute it to them by virtue of categories such as gender, age, social standing, education, and so on.

f) Sequential time vs. Synchronous time, considering two parts: the relative importance cultures gives to the past/present/future, and their approach to structuring time. If a culture is oriented towards the past, the future is often seen as a repetition of past experiences, but if a culture leans more towards the present, day-by-day experiences tend to direct people's lives.

In a future-oriented culture, most human activities are directed toward future prospects and, in this case, the past is not considered to be vitally significant to the future. People who structure time sequentially tend to do one thing at a time, and prefer planning and keeping to plans once they have been made; people structuring time synchronically view past, present, and future as being interrelated. They usually do several things at once. Time commitments are desirable but are not absolute and plans are easily changed.

g) Internal direction vs. Outer direction, concerns the value people put to their environment. People who have an internal mechanistic view of nature usually view themselves as the point of departure for determining the right action while in the opposite side cultures focus on the environment rather than on themselves.

Cross-cultural studies have identified extremely useful to “pack” characteristics belonging to specific nations –National Cultures– to analyse how those impact on major business activities, from capital structure (Chui *et al*., 2002) to group performance (Gibson, 1999), so researchers have actively reviewed similarities in cultural-specific beliefs and attitudes related to diverse work-related aspects.

Additionally, there are sound opinions (Soares *et al.*, 2007) identifying reliable dimensions (Cultural Dimensions) to synthesise major distinguishing aspects of culture as a major contribution to cross-cultural research. Those provide an alternative to conceptualise and measure culture as a complex, multidimensional structure rather than as a simple categorical variable.

Soares *et al*. (2007), referring to ways of operationalising culture, mention Lenartowicz and Roth, in 1999, use the term “culture assessment” to identify a valid cultural grouping and propose the following typology: Ethnological description; Use of Proxies - Regional Affiliation; Direct Values Inference (DVI) and Indirect Values Inference (IVI).

Ethnological description pertains to qualitative approaches, typically sociological, psychological and/or anthropological, used as bases for identifying and/or comparing cultures, so this approach provides a descriptive appraisal of cultures.

Use of proxies consists of defining culture based on characteristics that reflect or resemble culture (e.g., nationality or place of birth) and is common in business applications because there is empirical support for within –and between– country differences making nationality an acceptable proxy of culture.

Direct Value inference comprises measuring the values of subjects in a sample, and inferring cultural characteristics based on the aggregation of these values while Indirect Values Inference uses secondary data to ascribe characteristics of cultural groupings without directly measuring members of the group.

The use of a limited number of dimensions to compare cultures has anthropological roots and identifying reliable dimensions to synthesise major distinguishing aspects of culture is a major contribution to cross-cultural research.

Regarding accounting issues, culture has an impact on each of the internal and external actors, helps to shape the accounting subsystems and thus favours the existence of different accounting models because, as explained by American anthropologists Ruth Benedict (1887-1948) and Margaret Mead (1901-1978) all societies, traditional or modern, face the same basic problems and what differs is the response found to solve them.

Such an argument caused a sociologist and a psychologist (Inkeles & Levinson, 1969) spread what their research showed as the basic and common problems faced globally, issues having consequences for the functioning of societies in groups belonging to such societies and individuals making up such groups:

- Relationship with authority.
- Conception of self, particularly: The relationship between individual and society, and the individual concept of masculinity and femininity.
- The way of dealing with conflict, including control of aggression and the way to express feelings.

Culture incorporates value systems, which have been studied for many years, to show that all social groups developed ethical systems to delineate the proper and improper behaviour. Evolution of social sciences helped putting aside the idea that those values could only be divine creation and facilitated psychologists starting to use terms like personality, attitude and adaptation, while anthropologists and sociologists did so referring to socialisation processes, social contract and rules including, lately, accounting.

The widespread acceptance of social science has allowed, unreservedly and from the twentieth century, to agree that values tend to be related to the context in which they are examined and it is possible to change those that are dysfunctional or abnormal.

Much of the research of the past eighty years has focused on the corresponding changing characteristics of values, attitudes and beliefs to conclude that most people tend to consider the generated rules in their own culture as relatively permanent aspects in their personal value systems (Rokeach, 1968).

According to Rokeach (1968, p. 203), "To say a person has a value implies he has the firm belief that a specific mode of conduct, or the ultimate state of existence, is personally and socially preferable over alternative modes of behaviour or past states of existence. Once a value is internalized it becomes a standard or criterion to guide action, to justify his own actions and those of others and to, morally, judge himself and others."

Previous definition integrates two different values: *instrumental*, which is related to modes of behaviour, and terminal, linked to later stages of life. First one refers to aspects wanted at personal and social level, as honesty or determination, therefore, for the issue analysed in the present research, linked with the local accounting standards, which in this regard would not necessarily be similar to other countries, while the latter involve desirable and worthwhile endeavour items, as world peace or international standardisation of accounting principles.

Rokeach (1968) stated people have more *terminal* values than *instrumental* ones, due to the fact that in their "belief-attitude-value" hierarchy, *terminal* values happen to be primary and the *instrumental* ones are secondary, while other attitudes and beliefs are tertiary, in terms of importance, understanding the entire hierarchy as internally consistent and critical in determining behaviour.

It has been determined that most individuals belonging to a particular culture share common values sets which are composed of a relatively small number of basic elements, ranging from two to three dozen.

However, it is known that the importance attached to each of them is different from one individual to another; it is the result of "microcultural" factors such as age, race, sex, religion, family, class, chosen career and professional occupation (Rosenberg, 1957).

Heuer *et al*., cited by Leung *et al*. (2005), wondered if cultures of the various locales of the world were indeed converging in a way international business (IB) related practices would indeed become increasingly similar and, therefore, standard, culture-free business practices would eventually emerge, and inefficiencies and complexities associated with divergent beliefs and practices in the past era would disappear.

However, evidence on the issue showed that such an outlook, pertaining to the convergence of various IB practices, was overly optimistic and that culture can be an antecedent, a moderator or a mediator, and a consequence, while its effects may be domain-specific and are subjected to boundary conditions, so immediate challenge for the field was to map out more complex effects of culture systematically and integrate these effects routinely into substantive theories, in order to develop cultural elements constituting a major type of building block for theoretical models.

Then, one thing is clear: Importance of national culture has become increasingly important in the last two decades, largely as a result of the classic work of Hofstede (1980) who asserts that mental programs of people around the world do not change rapidly, but remain rather consistent over time.

1.2 MEASURING MULTICULTURAL EFFECTS. HOFSTEDE.

Several scholars, as cited by Soares *et al*. (2007), have discussed the choice of dimensions most appropriate for conceptualising and operationalising culture (Bond, 1987; Clark, 1990; Dorfman *et al*., 1988; Hofstede, 1984, 1991; Inkeles *et al*., 1969; Keillor *et al*., 1999; Schwartz, 1994; Smith *et al*., 1996; Steenkamp, 2001).

However, the firstly mentioned authors stated Hofstede's framework is the most widely used national cultural framework in psychology, sociology, marketing, or management studies.

Empirical research, aimed at identifying the relationship between cultures and accounting culture, before Geert Hofstede tried to use culture as an independent variable but having inferred it is an ambiguous concept, culture was not considered to serve as an independent variable.

Such a belief was confirmed by the Committee of Cultural Studies of the American Accounting Association (AAA, 1991, p. 182) where they stated: "The search for the independent variable in the intercultural research is complicated by the vagueness and ambiguity of the "culture "; a concept which is simply a name that integrates its component parts."

The ability to identify the aforementioned "component parts of culture", thus linking particular cultural attributes as an example of relevance to the present research through the specific attributes of financial reporting, were provided by Hofstede by breaking down the culture concept into four dimensions –he, later, identified a fifth and a sixth dimension– and quantitative measures for those dimensions by country, which are then supplied as independent variables for statistical analysis.

As a starting point, it is recognised that social systems can only exist because human behaviour is not random but somewhat predictable when both, the individual and the situation, are taken simultaneously into account because it is assumed that each individual acts based on specific mental programming that is stable over time and causes the same person shows a more or less similar behaviour in similar situations.

Although predictions on human behaviour are not always materialised in the planned situations, such predictions become more accurate the more you know about the mind-set of the person and the situation.

Considering it is not possible to directly observe the mental programming of individuals, behaviours can indeed be examined, meaning words and deeds of people, to infer –from them– the presence of stable mental programs; as in physics the intangible concept of force is inferred from its manifestations in the movement of objects.

To describe the mental programs for individuals, given their intangibility, models from verbal statements and other behaviours are useful for predicting new measurable behaviours, both verbal and nonverbal, and also to differentiate among the three uniqueness levels of these programs:

- The *universal* level, shared by almost all of humanity;

- The *collective* one, shared with some people but not all of them and common only to people belonging to a particular group or category; and
- The *individual* one, where there is a wide range of alternative behaviours within the same cultural community.

In the *universal* basis of mental programs the bulk of inherited behaviour, as a result of the genetic information, is identified, while in the *individual* part such heritage becomes irrelevant, but it is precisely in the *collective* part where mental programming is primarily configured and learn, as demonstrated by the fact that it is shared by people who went through the same learning process but do not share genes, then resulting in societies, organisations and groups having ways to keep and spare the mental programs from generation to generation, even with some degree of stubbornness that tends to be dismissed.

So, to describe the mental programs it is necessary to differentiate between values and culture; clarifying that the former are attributes of both individuals and communities while culture invariably presupposes a community.

Hofstede (Hofstede 1980, p. 19) defines values as "a broad tendency to prefer certain situations over others", mentioning that it is a simplified version of anthropological precise definitions but that is totally aligned to that proposed by Rokeach (1968), which was transcribed previously in this thesis.

He also mentions that, because our values are programmed early in our lives, those are not rational –even when we can subjectively believe that ours are perfectly rational– but, in fact, these values determine our subjective definition of rationality and values relate to each other to form hierarchies whose value systems are not necessarily harmonised, helping the internal conflict between values to be a source of uncertainty in social systems, to reach a situation perceived as "favourable" or "censured" for the individual.

From the above, he (Hofstede 1980, p. 25) defines culture as "the collective programming of the mind which distinguishes the members of a group from others."

Then he clarifies this definition includes value systems and that *culture* – learned and specific to group or category and to be distinguished from *human nature*, universal & inherited, on one side, and from an individual's *personality*, specific to individual, inherited and learned, which are the three levels of uniqueness in human mental programming– is to a human community what personality is for an individual and therefore constitutes: "an interactive set of common characteristics that influences the response of a human group to their environment."

Hofstede (1980, p.27) suggests the scheme shown in figure 1.3 in the following page in reference to cultural differences and similarities among nations in order to identify the mechanism that allows companies to maintain stability in cultural patterns over time.

There is a system of corporate standards, at the centre of that exhibit, which is formed from the value systems (mental programs) shared by the majority groups of the population. Its origins lie in the variety of ecological factors, in the sense of factors that affect the physical environment.

The societal norms have led to the development and maintenance of the pattern of institutions in society with a particular form of structure and functioning, including family, educational systems, political issues and legislation.

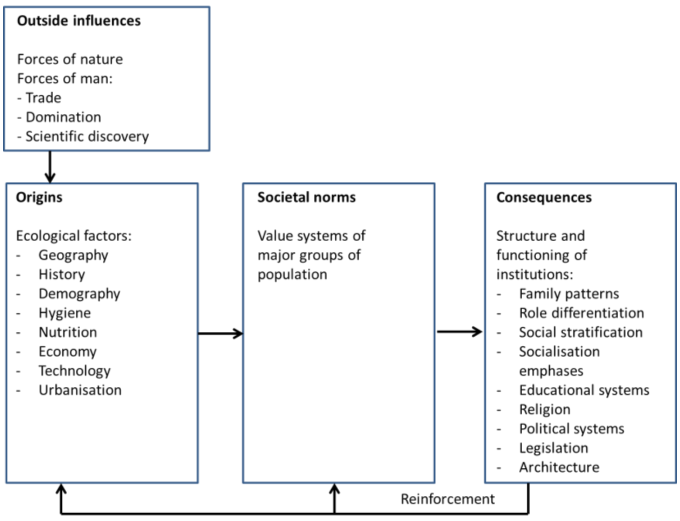

Figure 1.3 Stabilising of Culture Patterns

Once institutions have become facts, those reinforce societal norms and the ecological conditions that formed them and in relatively closed societies it is unlikely such a system to change completely.

Institutions may be changed, without necessarily affecting the societal norms; and when those remain unchanged, the persistent influence of the value system of a majority paves patiently to new institutions until their structures and functioning again adapt to societal norms.

Changes come mainly from the outside by forces of nature, such as climate change, or forces of man, such as trade, and that is why in figure 1.3 arrow goes deliberately to the roots and not the societal norms.

Hofstede (Hofstede, 1980, p. 27) states rules rarely change as a result of the direct adoption of external values –those rather do as a result of movements in ecological conditions: technology, economy and hygiene– and that, overall, changes in the standard will be gradual unless outside influences are violent.

Therefore, one of the most effective ways of changing individuals' mental programs is to change behaviour in first instance, because assuming change of values must precede behavioural change is an idealistic assumption that ignores the contribution of the situation on the current behaviour.

To meet the goal of statistically determining the relationship among measurable variables of a number of cultures, it is useful to use data matrices showing values obtained for a number of variables corresponding to a number of cultures, with the basic factor analysis method or other modern methods, such as cluster analysis or multidimensional scaling, which can reduce data to explain as much of the variance in the original matrix in the fewest possible factors.

Concepts referred to in Figure 1.3 and using methods mentioned in the previous paragraph allowed progress in the empirical analysis and Hofstede (Hofstede 1980) finalised his investigation dabbling in the field of international business organisations, specifically with IBM employees and 116,000 surveys conducted with individuals in 53 countries and 3 regions –whose full results are included later– first in

1968 and then in 1972, where he concluded identifying four dimensions in which he was able to locate the differences and similarities for the countries in his sample: Power Distance, Individualism, Masculinity and Uncertainty Avoidance.

His first dimension, Power Distance Index (PDI), was defined as the extent to which less powerful members of organisations and institutions (like the family) accept and expect that power is distributed unequally.

This represents inequality (more versus less), but defined from below, not from above. It suggests that a society's level of inequality is endorsed by the followers as much as by the leaders.

Societies reporting PDI high scores accept inequality and institutionalise it in hierarchies, which for the purpose of the present research could lead to a different way of dealing with earnings management.

In the opposite direction, nations with PDI low scores are typified by having a standard of value which demands to minimise inequality among people so that, while there are hierarchies within society and their organisations, these are only for administrative convenience, being more likely to be interested in participating avoiding earnings management.

Definition for the second dimension, Individualism (IDV), concerns the degree to which people in a society are integrated into groups; from individualism on the one side versus its opposite, collectivism, as a societal, not an individual characteristic.

In fact, individualistic societies depend upon the values of freedom and independence while the collectivistic ones depend on group harmony and consensus.

This dimension describes the relationships individuals have in each culture. In individualistic societies, individuals look after themselves and their immediate family (spouse and children) only; whereas in collectivistic cultures, individuals belong to groups (family, social net and companies they work for) that look after them in exchange for loyalty.

The word collectivism in this sense has no political meaning; as it refers to the group not to the state.

The fundamental aspect that reflects IDV is the degree of interdependence that keeps a society among individuals and it is characterised with a high level of individualism for people who focus on themselves –rather than in the group– for, under this perspective, a person is considered unique and complete, or having own identity that can be separated, and being independent, of their membership in a group, so they might tend to manage earnings if it is good for themselves.

Moreover, nations with low Individualism see the person as a whole when considered for his membership in a group, as it is the group, not the individual, who is seen as a basic unit of society and therefore they might think about how various local groups would be affected by earnings management.

The third dimension is Masculinity (MAS), defined –again as a societal, not an individual characteristic, and considering masculinity versus its opposite, femininity– as the distribution of emotional roles between the genders and shows the difference between dominant values versus the care for other people and the quality of life.

This explains the extent to which gender-related roles are emphasised and distinguishes between traditional male values –such as performance, heroism, assertiveness and achievement clearly visible to the others– and female traditional values, linked to the importance of relationships, cooperation, modesty, caring for the weak, concern for others and parenting.

Competition and a strong interest in reaching material achievements are characteristic of a high rank in this dimension, while interest to serve as a guide and to achieve higher levels of quality of life are considered "feminine" and are classified in the lower scales.

First one might be more interested in earnings management, while for the latter it would not be a natural extension of his actions.

Fourth dimension is Uncertainty Avoidance Index (UAI), defined as the extent to which society tolerates ambiguity, not being the same as risk avoidance as it indicates how a culture programs its members to feel either uncomfortable or comfortable in unstructured situations.

Unstructured situations are those novel, unknown, surprising or different from usual and this dimension deals with the need for well-defined rules for prescribed behaviour, denoting the degree to which members of a society feel threatened by uncertainty and ambiguity.

Hofstede (1980) suggests societies with a high level of UAI prefer to reduce threats generating rules, written or otherwise, to conduct themselves, to formalise organisational structure and to standardise procedures.

Societies with a low degree of UAI are more flexible and tolerant in relation to the way they should act or opinions that differ from their own.

So nations with high UAI scores might tend to report earnings fully complying with IFRS rules, for example, while the low scores ones might try to disclose figures in a more flexible way.

In short, a directly proportional behaviour might be observed for PDI, IDV and MAS (the higher the score more feasible the earnings management be used), but for UAI it is the opposite.

Surveys used by Hofstede (1980), to identify the previous four cultural dimensions, had been developed by a team of American, British, French, Dutch and Norwegian people –only Western scholars, with cultural bias inherent to case– but, almost simultaneously to obtaining the respective results, another intercultural values research was published, in 1982, finalised by a group of academic researchers originating from nine countries in Asia and the Pacific.

Above mentioned research –led by Canadian Professor Michael H. Bond, of the Chinese University of Hong Kong– was based on a modified version of the Rokeach Value Survey (Rokeach 1968), previously mentioned in the present research, and it was applied to 100 students, 50 women and 50 men, psychology students in each of ten ethnic or national groups.

Initial investigations of Hofstede and Rokeach Values Survey (RVS) did not lead to directly comparable results, as information was analysed in many different ways. However, Michael Bond decided to analyse RVS results following the same approach used for Hofstede´s data and concluded with five dimensions for the information of the RVS.

Four of them reflected a direct relationship with each of the IBM four value dimensions, in six countries that made up the sample, both for the IBM and the RVS, but the fifth dimension could not be interpreted by Bond and Hofstede in 1984.

Discovery of correlated dimensions confirmed the basic nature of the factors already mentioned in that document, being useful to emphasise that a different questionnaire was used as well as different kind of respondents –students rather than transnational's employees– and periods were 1970 and 1979, as the result of a restricted group of countries where four similar dimensions had been identified.

However, this second questionnaire had also been designed by Western minds and it was disturbing that, when applied between persons belonging to non-Western countries, some issues were irrelevant to them, but anyway they responded them, while other questions –which may have been more relevant to such a group– were not included.

The option to decentralise the research, generating questions developed by researchers from non-Western countries, presented the cultural problem that those who could draw them up might, even unconsciously, "respect" too much their Western project leader and, hence, attempt to westernise their attempt, or they might have been educated in Western universities and, therefore, reflect a Western-attitude adopted in their work.

To solve the problem, Bond –who had lived and worked in the Far East since 1971– asked a number of Chinese, Hong Kong and Taiwan social scientists, to develop a list of at least ten basic values for the Chinese people, which allowed him to build a questionnaire with 40 concepts, to use the same number as in the RVS, which was later translated into English and created a version, repeatedly verified by bilingual translators, which represented the closest example possible to that stipulated by the Asian minds and which was called the Chinese Value Survey (CVS).

Results reflected significant differences in the concept of virtue –quite important for Oriental minds– and truth, which was comparatively less relevant to them, so Bond decided to name the new fifth dimension as the Confucian Dynamism (referring to his teachings), after identifying the values reflected in the responses were related to the perseverance, hierarchical relationships and compliance with that order, frugality and sense of shame.

Hofstede and Bond (1988) refer to the following four key principles of Confucian teaching:

a) The stability of society is based on unequal relationships between people. The "wu lun," or five basic relationships, are ruler/ subject, father/son, older brother/younger brother, husband/wife, and older friend/ younger friend.
These relationships are based on mutual, complementary obligations: The junior partner owes the senior respect and obedience; the senior owes the junior protection and consideration.

b) The family is the prototype of all social organisations. A person is not primarily an individual; rather, he or she is a member of a family. Children should learn to restrain themselves, to overcome their individuality so as to maintain the harmony in the family (if only on the surface); one's thoughts, however, remain free.
Harmony is found in the maintenance of an individual's "face", meaning one's dignity, self-respect, and prestige. The use of our own word "face" in this sense was actually derived from the Chinese: Losing one's dignity, in the Chinese tradition, is equivalent to losing one's eyes, nose, and mouth. Social relations should be conducted in such a way that everybody's face is maintained. Paying respect to someone else is called "giving face."

c) Virtuous behaviour toward others consists of treating others as one would like to be treated oneself: a basic human benevolence, which, however, does not extend as far as the Christian injunction to love thy enemies.

As Confucius said, if one should love one's enemies, what would remain for one's friends?

d) Virtue with regard to one's tasks in life consists of trying to acquire skills and education, working hard, not spending more than necessary, being patient, and persevering.
Conspicuous consumption is taboo, as is losing one's temper. Moderation is enjoined in all things.

So the IBM studies revealed –for the 53 cultures included in the sample – that cultures differed mainly along the first four cultural dimensions identified, however, the three dimensions common to the Chinese Value Survey and the IBM studies were (Hofstede & Bond, 1988) "the ones that refer to three types of expected social behaviour: behaviour toward seniors or juniors, toward the group, and as a function of one's sex.

These represent cultural choices so fundamental to any human society that they are found regardless of whether the values surveyed were designed by a Western or an Eastern mind.

They are truly universal human traits in the sense that all societies share the same problems, but different societies have "chosen" (historically rather than consciously) different solutions to these problems".

Because, in practical terms, concepts previously mentioned related to the short or long term vision of life, the fifth dimension was initially known as Long Term Orientation (LTO) in the dimensions nomenclature validated by Hofstede (Hofstede 1997), and low scores might then be associated to more interest in earnings management.

LTO is defined as the level at which society creates a future-oriented, rather than a conventional historical and short-term vision, so it associates the connection of the past with the current and future actions/challenges and Hofstede mentions it is strongly correlated with economic growth.

So countries with low scores might be tempted to manipulate in order to achieve specific goals faster, while those with high scores would not be hurried by that kind of pressures and those might reason better results shall be achieved later on.

At this stage, a comparison in Table 1.1 of Hofstede's five dimensions to other approaches show a high level of convergence, supporting the theoretical relevance of his framework.

Comparison of Hofsede's cultural framework with other models

	Masculinity/ Feminity	Individualism/ collectivism	Power distance	Uncertainty avoidance	Long-term orientation	Other
Hofstede (1984)						
Hofstede (1991, 2001)						
Inkeles and Levinson (1969)*	Conceptions of self		Relation to authority	Primary dilemmas or conflicts		
Triandis (1995)						
Chinese Cultural Connection (1987)	Human heartedness	Integration			Confucian work dynamism	Moral discipline
Clark (1990)*	Relations to self		Relation to authority	Relation to risk		
Trompenaars (1997)	Neutral/emotional	Universalism/particularism Individualism/ communitarianism			Attitudes to time	Specific(diffuse Achievement/ascription Attitudes to the environment
Dorfman and Howell (1988)						Paternalism
Schwartz (1994)	Mastery/harmony	Autonomy/conservatism	Hierarchy/egalitarianism			
Smith *et al* . (1996)		Loyal involvement/ utilitarian involvement	Conervantism/ egalitarianism			Discussion of a third dimension 3 deferred
Keillor and Hult (1999)						National heritage/culture homogeneity/belief system/ consumer ethnocentrism
Steenkamp (2001)*		Autonomy/collectivism	Egalitarianism/hierarchy	Uncertainty avoidance	Mastery/ nurturance	

* Refers to theoretical contributions. The reminders are empirical studies.

Table 1.1 Cultural models comparison, reproduced from Soares *et al*. (2007, p. 280).

This framework has supported cross-cultural and mono-cultural studies, where researchers examined relationships between individuals' cultural values and various outcomes; however, in cross-cultural studies two or more countries are normally included, whereas in mono-cultural studies all individuals emanate from the same country.

Cultural values were associated with outcomes in management and applied psychology domains, including: change management; conflict management; decision-making; human resource management (HRM); leadership; organisational citizenship behaviour (OCB); work-related attitudes; negotiation behaviour; reward allocation; and individual behaviour relating to group processes and personality.

Researchers have favoured this five-dimension framework because of its clarity, parsimony, and resonance with managers. Also, 180 empirical researches had been published in top-tier journals, from 1980 to 2002 using this Hofstede's 5D model (Kirkman *et al*. 2006).

It is important to mention that value scores collected within IBM (Value Survey Module, or VSM 82), between 1967 and 1973, covered more than 70 countries, from which Hofstede first used the 40 countries with the largest groups of respondents and afterwards extended the analysis to 50 countries and 3 regions.

Subsequent studies validating the earlier results include such respondent groups as commercial airline pilots and students in 23 countries, civil service managers in 14 counties, 'up-market' consumers in 15 countries and 'elites' in 19 countries.

For the fifth dimension, added in 1991 and nowadays also referred to as Pragmatism (PRA), the survey was an applied to only 23 country and used VSM 94.

In 2010 a sixth dimension was added to the model: Indulgence versus Restraint (VR). This was based on Bulgarian sociologist Minkov's label and also drew on the extensive World Values Survey data for 81 countries and other newly available sources (VSM 08) and it is defined as "a tendency of the society to enjoy life on the one hand and/or to create stringent rules of behaviour on the other" (Kubátová, 2012). Therefore, a high score for IVR might be more attracted to earnings management.

Countries with high scores in IVR might be attracted to use earnings management if it makes easier for people involved with those actions to receive some kind of gratification and might be avoided if it is considered as something mandatory. Nations with a low score might be restrained by related accounting rules, as those are supposed to be followed to the verbatim.

Indulgence societies tend to allow relatively free gratification of natural human desires related to enjoying life and having fun whereas Restraint societies are more likely to believe that such gratification needs to be curbed and regulated by strict norms.

Indulgent cultures will tend to focus more on individual happiness and well-being, leisure time is more important and there is greater freedom and personal control. This is in contrast with restrained cultures where positive emotions are less freely expressed and happiness, freedom and leisure are not given the same importance.

Hofstede reported scores for the six previously mentioned dimensions and those were later adjusted using a scale running from 0 to 100 with 50 as a midlevel.

The rule of thumb is that if a score is under 50 the culture scores relatively LOW on that scale and if any score is over 50 the culture scores HIGH on that scale.

In the case of IDV - the LOW side (under 50) is considered "Collectivist" and above 50 considered "Individualist". A country with a score of 43 would be collectivist but less collectivist than someone with 28 who is moving down toward the 0 mark.

Hofstede mentions the grouping of country scores points to some of the roots of cultural differences. These should be sought in the common history of similarly scoring countries.

All Latin countries, for example, score relatively high on both power distance and uncertainty avoidance. Latin countries –those today speaking a Romance language i.e. Spanish, Portuguese, French, Italian or Romanian– have inherited at least part of their civilization from the Roman Empire.

The Roman Empire in its days was characterized by the existence of a central authority in Rome, and a system of law applicable to citizens anywhere. This established in its citizens' minds the value complex which we still recognize today: centralization fostered large power distance and a stress on laws fostered strong uncertainty avoidance.

The Chinese empire also knew centralization, but it lacked a fixed system of laws: it was governed by men rather than by laws. In the present-day countries once under Chinese rule, the mind-set fostered by the empire is reflected in large power distance but medium to weak uncertainty avoidance.

The Germanic part of Europe, including Great Britain, never succeeded in establishing an enduring common central authority and countries which inherited its civilizations show smaller power distance.

Assumptions about historical roots of cultural differences always remain speculative but in the given examples they are plausible.

Quantitative measures developed by Hofstede should be interpreted as relative ones because, by the way those were calculated, they measure only the differences between countries. However, it has been shown those allow to fully investigating their effect on various aspects of business, including various ways of management, compensation practices, implementation at work and cross-border acquisitions, so they will be used here to assess how they may influence on earnings management, using the original scores reported for the countries in this thesis sample.

With the intention of establishing a generalised comparison parameter, texts in the following pages –from the ITIM International Web page, a network based franchisee organisation, based in Helsinki, Finland, and license holders, currently in 32 countries, founded by Bob Waisfisz, with the assistance of Prof. Dr. Geert Hofstede, as the commercial spin-off of IRIC, an independent institute part of the University of Maastricht, the Netherlands– describe some management issues that may be related to earning management in the 16 countries sample used in the present thesis (ISO 3166-2 show acronym for those countries in parentheses):

BELGIUM (BE)

- PDI. Attitude towards managers is more formal and the information flow is hierarchical. The way information is controlled is even associated with power, therefore unequally distributed. Control is normal, and even expected, but considered as formal and not key for efficiency.
- IDV. It houses a “contradiction”: although highly Individualist, the Belgians need a hierarchy. This combination (high score on Power Distance and high score on Individualism) creates a specific “tension” in this culture, which makes the relationship so delicate but intense and fruitful once you manage it.

- Therefore, the manager is advised to establish a second "level" of communication, having a personal contact with everybody in the structure, allowing to give the impression that "everybody is important" in the organisation, although unequal.
- MAS. Reveals a difference between the Northern part of the country (Flemish) and the Southern part (French), the need for the Flemish to "close the circle" and "stay between natives" is a necessity to establish consensus, typical for a more Feminine culture. The cultural priority for the French-speaking part is the opposite: to be part of a "global Latin culture" typically made of "universal values".
- UAI. Rules and security are welcome and if lacking, it creates stress. Therefore planning is favoured, some level of expertise welcome, when change policies on the other hand are considered stressful. Both communities North & South share this score on the dimension, which makes it very painful when negotiating a new set of rules.
- PRA. Ability to adapt traditions easily to changed conditions, a strong propensity to save and invest, thriftiness and perseverance in achieving results, so people believe that truth depends very much on situation, context and time.
- IVR. They place a higher degree of importance on leisure time, act as they please and spend money as they wish.

CANADA (CA)

- PDI. It is customary for managers and staff members to consult one another and to share information freely. With respect to communication, Canadians value a straightforward exchange of information.
- IDV. Within the exchange-based world of work, hiring and promotion decisions are based merit or evidence of what one has done or can do.
- MAS. While Canadians strive to attain high standards of performance, the overall cultural tone is more subdued with respect to achievement, success and winning.

- UAI. Easy acceptance of new ideas, innovative products and a willingness to try something new or different, whether it pertains to technology or business practices but, at the same time, Canadian culture is not rules-oriented.
- PRA. Normative way in their thinking, so they exhibit great respect for traditions, a relatively small propensity to save for the future, and a focus on achieving quick results.
- IVR. A higher degree of importance on leisure time, act as they please and spend money as they wish.

GERMANY (DE)

- PDI. Co-determination rights are comparatively extensive and have to be taken into account by the management. A direct and participative communication and meeting style is common, control is disliked and leadership is challenged to show expertise and best accepted when it’s based on it.
- IDV. Loyalty is based on personal preferences for people as well as a sense of duty and responsibility. This is defined by the contract between the employer and the employee.
- MAS. Dominant values in society are caring for others and quality of life. A Feminine society is one where quality of life is the sign of success and standing out from the crowd is not admirable.
- UAI. Germans prefer to compensate for their higher uncertainty by strongly relying on expertise, so there is a strong preference for deductive rather than inductive approaches, be it in thinking, presenting or planning: the systematic overview has to be given in order to proceed.
- PRA. People believe that truth depends very much on situation, context and time. They show an ability to adapt traditions easily to changed conditions, a strong propensity to save and invest, thriftiness and perseverance in achieving results.
- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires.

People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

SPAIN (ES)

- PDI. People accept a hierarchical order in which everybody has a place and which needs no further justification.

  Hierarchy in an organisation is seen as reflecting inherent inequalities, centralisation is popular, subordinates expect to be told what to do and the ideal boss is a benevolent autocrat.
- IDV. Teamwork is considered as something totally natural; employees tend to work in this way with no need for strong motivation from Management.
- MAS. Managers like to consult their subordinates to know their opinions and, according to it, make their decisions and they try to avoid the dominant presence of just one winning party. It is the country opposite to ‘the winner takes it all’.
- UAI. People like to have rules for everything, changes cause stress, but, at the same time, they are obliged to avoid rules and laws that, in fact, make life more complex.

  Confrontation is avoided as it causes great stress and scales up to the personal level very quickly. There is great concern for changing, ambiguous and undefined situations.
- PRA. People look for quick results without delays. Moreover, there is a need for clear structures and well defined rules prevailing against more pragmatic and relaxed approaches to life, particularly, in the long term time.
- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires.

  People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

FRANCE (FR)

- PDI. Many comparative studies have shown that French companies have normally one or two hierarchical levels more than comparable companies in Germany and the UK. Superiors have privileges and are often inaccessible. CEO's of big companies are called Mr. PDG, which is a more prestigious abbreviation than CEO, meaning President Director General. These PDGs have frequently attended the most prestigious universities called "grandes écoles", big schools.
- IDV. Subordinates normally pay formal respect and show deference to their boss, but behind his/her back they may do the opposite of what they promised to do, as they may think that they know better, yet are not able to express so. Another reflection of high Power Distance contrary to formal obedience is the total rejection of those in power as there is no way to change by evolution but only by strikes, revolts and revolution.
- MAS. The upper class scores Feminine while the working class scores Masculine. This characteristic has not been found in any other country.
- UAI. There is a strong need for laws, rules and regulations to structure life. This, however, doesn't mean that most Frenchmen will try to follow all these rules, the same as in other Latin countries. Given the high score on Power Distance, which means that power holders have privileges, power holders don't necessarily feel obliged to follow all those rules which are meant to control the people in the street. At the same time, commoners try to relate to power holders so that they can also claim the exception to the rule.
- PRA. People believe that truth depends very much on situation, context and time. They show an ability to adapt traditions easily to changed conditions, a strong propensity to save and invest, thriftiness and perseverance in achieving results.
- IVR. A high score on Uncertainty Avoidance implies that the French are less relaxed and enjoy life less often than is commonly assumed. Indeed, France scores not all that high on the happiness indices.

UNITED KINGDOM (GB)

- PDI. Score at first seems incongruent with the well-established and historical British class system and its exposes one of the inherent tensions in the British culture – between the importance of birth rank on the one hand and a deep seated belief that where you are born should not limit how far you can travel in life. A sense of fair play drives a belief that people should be treated in some way as equals.
- IDV. British are a highly Individualist and private people. Children are taught from an early age to think for themselves and to find out what their unique purpose in life is and how they uniquely can contribute to society. The route to happiness is through personal fulfilment.
- MAS. Critical to understanding the British is being able to ‘’read between the lines’’ What is said is not always what is meant. In comparison to Feminine cultures such as the Scandinavian countries, people in the UK live in order to work and have a clear performance ambition.
- UAI. There are generally not too many rules in British society, but those that are there are adhered and in work terms this results in planning that is not detail oriented – the end goal will be clear (due to high MAS) but the detail of how we get there will be light and the actual process fluid and flexible to emerging and changing environment. Planning horizons will also be shorter.
- PRA. With an intermediate score of 51 in this dimension, a dominant preference in British culture cannot be determined.
- IVR. They exhibit a willingness to realise their impulses and desires with regard to enjoying life and having fun.

  They possess a positive attitude and have a tendency towards optimism. In addition, they place a higher degree of importance on leisure time, act as they please and spend money as they wish.

HONG KONG (HK)

- PDI. A society that believes that inequalities amongst people are acceptable. The subordinate-superior relationship tends to be polarised and there is no defence against power abuse by superiors. Individuals are influenced by formal authority and sanctions and are in general optimistic about people's capacity for leadership and initiative.
- IDV. People act in the interests of the group and not necessarily of themselves. Whereas relationships with colleagues are cooperative for in-groups they are cold or even hostile to out-groups. Personal relationships prevail over task and company.
- MAS. The need to ensure success can be exemplified by the fact that many will spend many hours at work while students care very much about their exam scores and ranking as this is the main criteria to achieve success or not.
- UAI. Adherence to laws and rules may be flexible to suit the actual situation and pragmatism is a fact of life. The people in Hong Kong are comfortable with ambiguity.
- PRA. People believe that truth depends very much on situation, context and time. They show an ability to adapt traditions easily to changed conditions, a strong propensity to save and invest, thriftiness and perseverance in achieving results.
- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

INDIA (IN)

- PDI. Real Power is centralized even though it may not appear to be and managers count on the obedience of their team members. Employees expect to be directed clearly as to their functions and what is expected of them. Control is familiar, even a psychological security.

- IDV. A society with both collectivistic and Individualist traits. The collectivist side means that there is a high preference for belonging to a larger social framework in which individuals are expected to act in accordance to the greater good of one's defined in-group(s) but, on the other hand, people are, therefore, individually responsible for the way they lead their lives and the impact it will have upon their rebirth.

  This focus on individualism interacts with the otherwise collectivist tendencies of the Indian society which leads to its intermediate score on this dimension.

- MAS. Highly attracted to visual display of success and power but India is also a spiritual country with millions of deities and various religious philosophies. It is also an ancient country with one of the longest surviving cultures which gives it ample lessons in the value of humility and abstinence.
- UAI. There is acceptance of imperfection; nothing has to be perfect nor has to go exactly as planned. India is traditionally a patient country where tolerance for the unexpected is high; even welcomed as a break from monotony. People generally do not feel driven and compelled to take action-initiatives and comfortably settle into established rolls and routines without questioning.
- PRA. Time is not linear, and thus is not important, so they forgive a lack of punctuality, a changing game-plan based on changing reality and a general comfort with discovering the fated path as one goes along rather than playing to an exact plan, while there is an acceptance that there are many truths and often depends on the seeker.
- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires.

  People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

JAPAN (JP)

- PDI. They show a painstakingly slow decision making process: all the decisions must be confirmed by each hierarchical layer and finally by the top management and the exact example of their slow decision making process shows that in Japanese society there is no one top guy who can take decision like in more hierarchical societies.
- IDV. People are loyal to their inner group by birth, such as their extended family and their local community. Japanese are experienced as collectivistic by Western standards and experienced as Individualist by Asian standards. They are more private and reserved than most other Asians.
- MAS. In corporate Japan, you see that employees are most motivated when they are fighting in a winning team against their competitors. What you also see as an expression of Masculinity in Japan is the drive for excellence and perfection in their material production (monodukuri) and in material services (hotels and restaurants) and presentation (gift wrapping and food presentation) in every aspect of life. Notorious Japanese workaholics are another expression of their Masculinity. It is still hard for women to climb up the corporate ladders in Japan with their Masculine norm of hard and long working hours.
- UAI. A lot of time and effort is put into feasibility studies and all the risk factors must be worked out before any project can start. Managers ask for all the detailed facts and figures before taking any decision. This high need for Uncertainty Avoidance is one of the reasons why changes are so difficult to realize in Japan.
- PRA. Constant high rates of investment in R&D, even in economically difficult times; higher own capital rate, priority to steady growth of market share rather than to a quarterly profit, and so on, illustrates they all serve the durability of the companies. The idea behind it is that the companies are not here to make money every quarter for the shareholders, but to serve the stake holders and society at large for many generations to come.

- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

KOREA (KR)

- PDI. Hierarchy in an organisation is seen as reflecting inherent inequalities, centralisation is popular, subordinates expect to be told what to do and the ideal boss is a benevolent autocrat.
- IDV. A close long-term commitment to the member 'group', being that a family, extended family, or extended relationships. Loyalty in a collectivist culture is paramount, and over-rides most other societal rules and regulations. The society fosters strong relationships where everyone takes responsibility for fellow members of their group. In collectivist societies offence leads to shame and loss of face, employer/employee relationships are perceived in moral terms (like a family link), hiring and promotion decisions take account of the employee’s in-group, management is the management of groups.
- MAS. Managers strive for consensus, people value equality, solidarity and quality in their working lives. Conflicts are resolved by compromise and negotiation. Incentives such as free time and flexibility are favoured. Focus is on well-being, status is not shown. An effective manager is a supportive one, and decision making is achieved through involvement.
- UAI. There is an emotional need for rules (even if the rules never seem to work) time is money, people have an inner urge to be busy and work hard, precision and punctuality are the norm, innovation may be resisted, security is an important element in individual motivation.
- PRA. In corporate South Korea, you see long term orientation in the, higher own capital rate, priority to steady growth of market share rather than to a quarterly profit, and so on. They all serve the durability of the companies.

The idea behind it is that the companies are not here to make money every quarter for the shareholders, but to serve the stake holders and society at large for many generations to come.

- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

NETHERLANDS (NL)

- PDI. Being independent, hierarchy for convenience only, equal rights, superiors accessible, coaching leader, management facilitates and empowers. Power is decentralised and managers count on the experience of their team members. Employees expect to be consulted. Control is disliked and attitude towards managers are informal and on first name basis.
- IDV. In Individualist societies offence causes guilt and a loss of self-esteem, the employer/employee relationship is a contract based on mutual advantage, hiring and promotion decisions are supposed to be based on merit only, management is the management of individuals.
- MAS. In Feminine countries it is important to keep the life/work balance and you make sure that all are included. An effective manager is supportive to his/her people, and decision making is achieved through involvement. Managers strive for consensus and people value equality, solidarity and quality in their working lives. Conflicts are resolved by compromise and negotiation and Dutch are known for their long discussions until consensus has been reached.
- UAI. In these cultures there is an emotional need for rules (even if the rules never seem to work) time is money, people have an inner urge to be busy and work hard, precision and punctuality are the norm, innovation may be resisted, security is an important element in individual motivation.
- PRA. People believe that truth depends very much on the situation, context and time. They show an ability to easily adapt traditions to changed conditions, a

strong propensity to save and invest, thriftiness and perseverance in achieving results.

- IVR. People in societies classified by a high score in Indulgence generally exhibit a willingness to realise their impulses and desires with regard to enjoying life and having fun. They possess a positive attitude and have a tendency towards optimism. In addition, they place a higher degree of importance on leisure time, act as they please and spend money as they wish.

PHILIPPINES (PH)

- PDI. People accept a hierarchical order in which everybody has a place and which needs no further justification. Hierarchy in an organisation is seen as reflecting inherent inequalities, centralisation is popular, subordinates expect to be told what to do and the ideal boss is a benevolent autocrat.
- IDV. The society fosters strong relationships where everyone takes responsibility for fellow members of their group. In collectivist societies offence leads to shame and loss of face, employer/employee relationships are perceived in moral terms (like a family link), hiring and promotion decisions take account of the employee’s in-group, management is the management of groups.
- MAS. People “live in order to work”, managers are expected to be decisive and assertive, the emphasis is on equity, competition and performance and conflicts are resolved by fighting them out.
- UAI. Low UAI societies maintain a more relaxed attitude in which practice counts more than principles and deviance from the norm is more easily tolerated. In societies exhibiting low UAI, people believe there should be no more rules than are necessary and if they are ambiguous or do not work they should be abandoned or changed.
- PRA. People in such societies have a strong concern with establishing the absolute Truth; they are normative in their thinking. They exhibit great respect for traditions, a relatively small propensity to save for the future, and a focus on achieving quick results.

- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

PORTUGAL (PT)

- PDI. Hierarchical distance is accepted and those holding the most powerful positions are admitted to have privileges for their position. Management controls, i.e. the boss requires information from his subordinates and these expect their boss to control them.

  A lack of interest towards a subordinate would mean this one is not relevant in the organisation.
  At the same time, this would make the employee feel unmotivated. Negative feedback is very distressed so for the employee it is more than difficult to provide his boss with negative information.
  The boss needs to be conscious of this difficulty and search for little signals in order to discover the real problems and avoid becoming relevant.
- IDV. Loyalty in a collectivist culture is paramount, and over-rides most other societal rules and regulations. The society fosters strong relationships where everyone takes responsibility for fellow members of their group. In collectivist societies offence leads to shame and loss of face, employer/employee relationships are perceived in moral terms (like a family link), hiring and promotion decisions take account of the employee’s in-group, management is the management of groups.
- MAS. In Feminine countries the focus is on “working in order to live”, managers strive for consensus, people value equality, solidarity and quality in their working lives. Conflicts are resolved by compromise and negotiation. Incentives such as free time and flexibility are favoured. Focus is on well-being, status is not shown. An effective manager is a supportive one, and decision making is achieved through involvement.

- UAI. If there is a dimension that defines Portugal very clearly, it is Uncertainty Avoidance. Portugal scores 99 on this dimension and thus has a very high preference for avoiding uncertainty. Countries exhibiting high Uncertainty Avoidance maintain rigid codes of belief and behaviour and are intolerant of unorthodox behaviour and ideas. In these cultures there is an emotional need for rules (even if the rules never seem to work) time is money, people have an inner urge to be busy and work hard, precision and punctuality are the norm, innovation may be resisted, security is an important element in individual motivation.
- PRA. People in such societies have a strong concern with establishing the absolute Truth; they are normative in their thinking. They exhibit great respect for traditions, a relatively small propensity to save for the future, and a focus on achieving quick results.
- IVR. Restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong.

SWEDEN (SE)

- PDI. Being independent, hierarchy for convenience only, equal rights, superiors accessible, coaching leader, management facilitates and empowers. Power is decentralised and managers count on the experience of their team members. Employees expect to be consulted.

  Control is disliked and attitude towards managers are informal and on first name basis. Communication is direct and participative.
- IDV. There is a high preference for a loosely-knit social framework in which individuals are expected to take care of themselves and their immediate families only. In Individualist societies offence causes guilt and a loss of self-esteem, the employer/employee relationship is a contract based on mutual advantage, hiring and promotion decisions are supposed to be based on merit only, management is the management of individuals.

- MAS. The whole culture is based around 'lagom', which means something like not too much, not too little, not too noticeable, everything in moderation. Lagom ensures that everybody has enough and nobody goes without. Lagom is enforced in society by “Jante Law” which should keep people “in place” at all times. It is a fictional law and a Scandinavian concept which counsels people not to boast or try to lift themselves above others.
- UAI. Low UAI societies maintain a more relaxed attitude in which practice counts more than principles and deviance from the norm is more easily tolerated. In societies exhibiting low UAI, people believe there should be no more rules than are necessary and if they are ambiguous or do not work they should be abandoned or changed. Schedules are flexible, hard work is undertaken when necessary but not for its own sake, precision and punctuality do not come naturally, innovation is not seen as threatening.
- PRA. With an intermediate score of 53 Sweden is seen to not express a clear preference on this dimension.
- IVR. People in societies classified by a high score in Indulgence generally exhibit a willingness to realise their impulses and desires with regard to enjoying life and having fun.

  They possess a positive attitude and have a tendency towards optimism. In addition, they place a higher degree of importance on leisure time, act as they please and spend money as they wish.

THAILAND (TH)

- PDI. It is a society in which inequalities are accepted; a strict chain of command and protocol are observed. Each rank has its privileges and employees show loyalty, respect and deference for their superiors in return for protection and guidance. This may lead to paternalistic management. Thus, the attitude towards managers is more formal, the information flow is hierarchical and controlled.
- IDV. The society fosters strong relationships where everyone takes responsibility for fellow members of their group. In order to preserve the in-group, Thai are not confrontational and in there communication a “Yes” may

not mean an acceptance or agreement. An offence leads to loss of face and Thai are very sensitive not to feel shamed in front of their group. Personal relationship is the key to conducting business and it takes time to build such relations thus patience is necessary as well as not openly discuss business on first occasions.

- MAS. A society with less assertiveness and competitiveness, as compared to one where these values are considered more important and significant. This situation also reinforces more traditional male and female roles within the population.
- UAI. In order to minimize or reduce the level of uncertainty, strict rules, laws, policies, and regulations are adopted and implemented. The ultimate goal of this population is to control everything in order to eliminate or avoid the unexpected. As a result of this high Uncertainty Avoidance characteristic, the society does not readily accept change and is very risk adverse. Change has to be seen for the greater good of the in group.
- PRA. Thai culture is more normative than pragmatic. People in such societies have a strong concern with establishing the absolute Truth; they are normative in their thinking. They exhibit great respect for traditions, a relatively small propensity to save for the future, and a focus on achieving quick results.
- IVR. With an intermediate score of 45, a preference on this dimension cannot be determined for Thailand.

TAIWAN (TW)

- PDI. People accept a hierarchical order in which everybody has a place and which needs no further justification. Hierarchy in an organisation is seen as reflecting inherent inequalities, centralisation is popular, subordinates expect to be told what to do and the ideal boss is a benevolent autocrat.
- IDV. Such a society fosters strong relationships, where everyone takes responsibility for fellow members of their group. In collectivistic societies, offence leads to shame and loss of face. Employer/employee relationships are perceived in moral terms (like a family link), hiring and promotion take account of the employee’s in-group. Management is the management of groups.

- MAS. In Feminine countries the focus is on “working in order to live”, managers strive for consensus, people value equality, solidarity and quality in their working lives. Conflicts are resolved by compromise and negotiation. Incentives such as free time and flexibility are favoured. Focus is on well-being, status is not shown. An effective manager is a supportive one, and decision making is achieved through involvement.
- UAI. There is an emotional need for rules (even if the rules never seem to work) time is money, people have an inner urge to be busy and work hard, precision and punctuality are the norm, innovation may be resisted, security is an important element in individual motivation.
- PRA. Societies with this orientation show an ability to adapt traditions to a modern context i.e. pragmatism, a strong propensity to save and invest, thriftiness, perseverance in achieving results and an overriding concern for respecting the demands of Virtue. The countries of South East Asia and the Far East are typically found at the long-term end of this dimension.
- IVR. Taiwan has a very intermediate score of 49 which does not indicate the dominant preference on this dimension.

Wursten *et al*. (2009), based on Hofstede’s research, developed an article setting out why a customer service strategy must incorporate cultural diversity awareness where they included the following six culture clusters, so countries in the present thesis sample are mentioned therein:

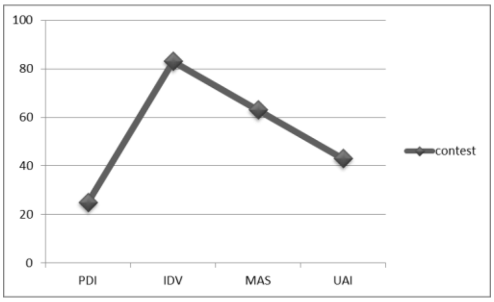

Figure 1.4 Contest cluster

- Contest cluster. This one corresponds to Anglo-Saxon countries, like the UK, where competitiveness is a must, related to well-understood self-interest and with the cultural dimensions scores shown in the figure above.

- Network cluster. Focusing on the Netherlands where everyone is supposed to be involved in decision-making due to the below shown scores:

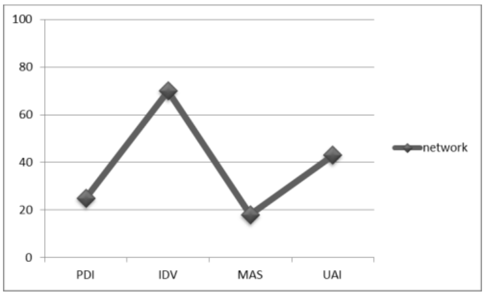

Figure 1.5 Network cluster

- Pyramid cluster. Represented by Portugal and found in collective societies where loyalty, hierarchy and implicit order are highly appreciated, as shown in figure 1.6 in the following page.

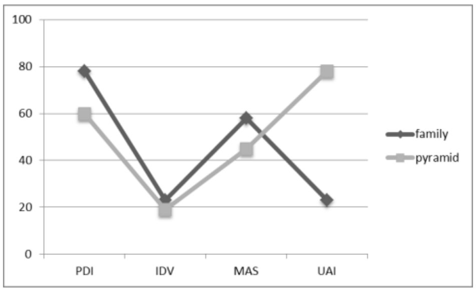

Figure 1.6 Pyramid and Family clusters

- Family cluster. Including China and India, where people will try to avoid uncertain situations and have powerful in-groups, paternalistic leaders and a high value for loyalty and hierarchy, with scores shown in the figure above.
- Solar cluster. Exemplified by France and Belgium, similar to the previous two but with hierarchy and impersonal bureaucracy, so they look for efficiency, structure and accuracy:

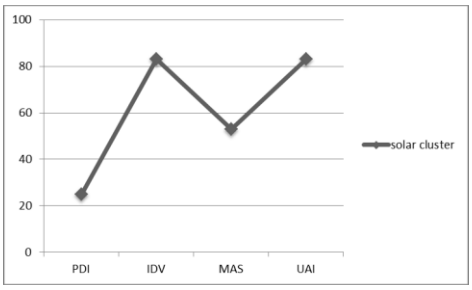

Figure 1.7 Solar cluster

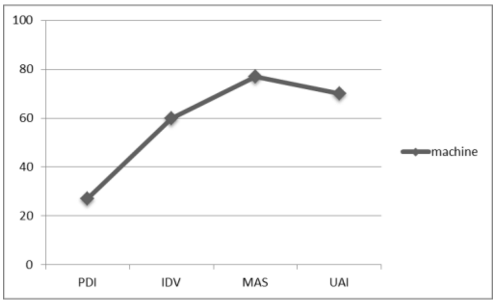

Figure 1.8 Well-oiled machine cluster

- Well-oiled machine cluster. With Germany as the characteristic example, where there is an emphasis on carefully balanced procedures and rules, due to the high uncertainty avoidance and those other scores shown in figure 1.8.

In another article about change management, Wursten (2008) referred to the cognitive dissonance, a psychological phenomenon that all cultures facing a change have in common. It refers to the discomfort felt when there is a discrepancy between what you already know or believe and new information, and why things should be done differently is cultural sensitive, meaning it cannot be understood identically in different countries.

So in the first cluster –Contest– people can be willing to overcome resistance to change if doing things in a different way is good for their next career step or for gaining a material reward, while in the second one –Network– there is a reluctance to believe that someone else can define what is good for the organization, as work motivation is very much connected to people's own work field, so they think they, more than others, know what important steps should be taken to improve situations and that the only good decisions are those where all the stakeholders are consulted from the beginning and participate in the decision-making process.

Then, in the Pyramid and Family clusters, the privilege to define new priorities and directions lies at the top of the organisation, as the person at the top is supposed to indicate what he or she sees as the common interest for all insiders, in the company or even society, and he or she should be able to provide new mandates giving unambiguous directions.

The person at the top of the Solar cluster has the sole right to decide what the new direction and priorities should be, as he or she is supposed to have an overview of everything that is taking place, however and different from the previous two, group interest is not a first priority, instead the future of the company –or society– takes precedence irrespective of in-groups.

Finally, in the Well-oiled machine cluster, the most important issue is that perceived and recognised experts are the ones who are believed to be in a position to define new directions; therefore credibility should lead agreements upon balanced interest by experts.

The previously mentioned approach makes the influence of culture, at least for the considered five dimensions and nine specific countries, visible and tangible into more homogeneous segments, focusing on cultural similarities while taking into account cultural differences, which might help assessing earnings management choices in the present research.

The author did not mention 8 of the countries in the present thesis sample: Canada, Japan, Korea, Philippines, Spain, Sweden, Thailand and Taiwan, but their scores make it possible to assign them to a cluster.

Hofstede's research identified national cultural dimensions as a guide for management and organisational development, but he made clear their relevance in the accounting field by mentioning accounting systems are uncertainty avoiding rituals so one can expect a society's score on UAI will strongly affect its accounting practices so in countries with high UAI scores there might be more precise related rules, while in those with low scores more will be left to the discretion of the accountant.

He also stated that technical necessities have an inverse relation to values and rules; therefore accountings being an area where technical imperatives are weak, historical conventions are more important than laws of nature so accounting systems vary along natural cultural lines.

And he shared a couple of examples: In large power distance countries accounting systems will frequently be used to justify the decisions of the top power holder(s): they are seen as the power holder's tool to present the desired image, and figures will be twisted to this end.

His second example relates to multinationals as they have to impose universal accounting rules for consolidation purpose, but then employees in different countries hold quite different personal values, so it is likely that interpretation of accounting rules in the subsidiaries will often deviate from what headquarters expect.

1.3 ACCOUNTING SYSTEMS DIFFERENCES.

1.3.1 Accounting systems.

An important area, then, of cultural values that have been investigated is the potential role of culturally derived national accounting values on the quality of financial reporting.

So it is advisable to examine now useful information about such a linkage in order to have a clear understanding about the way country-specific differences in accounting systems, originated from legal traditions, might impact on earnings management.

In first instance it is useful to recall that accounting systems, in the broadest sense, are defined as "the set of factors intrinsic to the system –internal agents– that, through the modelling they are subject to through their own interrelationships and external influences –outside agents– conform a properly structured "whole", capable of meeting needs assigned to the accounting function in different areas” (Jarne 1997, p. 43).

Then it is also convenient to recall that, a debate about the current importance of the Anglo-Saxon vs. Continental accounting models, which will be discussed in the following pages, has been taken up by some authors.

As quoted by Callao, Ferrer, Jarne & Lainez (2010), Alexander & Archer, in 2000, using logical analysis; later D’Arcy, in 2001, using regulations and finally Lewis & Salter, in 2006, using reported results from 20-F filings identified just two main accounting groups in the world, one being the EU and a US influenced the other one. So several authors are now questioning whether, for example, U.K. should still be considered as an Anglo-Saxon system member or Spain one in the European Continental model.

Due to historical differences between accounting systems internationally, as a result of the search for adequate answers to social demands from each country and the multitude of factors that influence them, it is clear that a response to similar problems is shown in different ways, with the particular combination of factors specific to each country –and, in a relevant way, the corresponding cultural impact– which also generates a unique system.

Jarne (1997, p. 44 to 53) mentions five factors related to insiders and other seven for outsiders:

- Internal agents.

a) Influence on tax accounting.
b) Main accounting information users.
c) Development level of the accounting profession.
d) Accounting education stage.
e) Accounting objectives.

- External agents.

a) Legal system.

b) Main supplier of corporate finance.

c) Nationalism.

d) Business organisation.

e) Stock market stage of development.

f) Cultural factors.

g) Political system

To simplify description and comparison of different existing accounting systems in the world, according to their attributes, the purpose of the main demand aimed at all accounting system is taken into consideration: incorporation of useful accounting information, into the economic system, for their users.

So Jarne (1997) proposes to analyse the six subsystems that integrate all accounting system: Regulatory; Accounting Principles; Professional; Accounting Training; Valuation Practices and Information Practices.

The Regulatory subsystem deals with aspects related to gestation, processing, development and implementation of accounting regulations, including –in the genesis process of the standard– the concerns and needs of different agents affected by it, to govern on generation and disclosure of corporate financial information.

Accounting principles consider the part of the accounting system which, through the definition of some fundamental accounting concepts (GAAP), draws the line to be followed to obtain financial statements reflecting the true picture about assets, financial condition and inherent results on companies.

A Professional subsystem shows the part of the accounting system comprising activity performed by professional accountants and auditors, combining interest public protection and meeting needs of their customers, as well as the performance of professionals in accounting organisations and multinationals auditing.

Accounting Training is the part of the accounting system responsible for developing the basic knowledge and skills to apply accounting principles and standards, and to transmit those to a group of agents capable of applying them (professionals) and of structuring the logical route to obtain, by the professionals, professional qualification (accountants' expertise).

Valuation Practices are the part of the accounting system reflecting the objective criteria followed in the process of recognition, measurement and accounting valuation, shaping those up to be included in the financial statements and reports, in monetary terms, about economic flows, rights, obligations and other changes in the company's equity structure arising from transactions made by the same.

Information Practices refer to that part of the accounting system responsible for determining volume and format for accounting information, pre-processed, which will provided to outsiders, and for the frequency and mechanisms for such communication.

By the time Jarne (1997) prepared his paper, there was evidence about three great Regulatory Subsystems worldwide:

a) Public accounting regulation. Characterized mostly in mainland Europe, with a legalistic orientation and participation of government agencies, without a definite framework but with detailed regulations enforced by law, the existence of an Accounting Plan and relevance on the "form" rather than the "substance".
b) Private accounting regulation. Extensively applied in the Anglo-Saxon area, with some government support, well-structured professional accounting organisations, and flexible regulatory framework –with no excessive details– and placing greater emphasis on the "substance" rather than in the "form".
c) Mixed systems. Deriving from interrelations of the above mentioned two models.

The Professional subsystems included three different levels:

a) Individual performances from those executing the accounting profession, who try to achieve their views, are considered in the process of developing standards.
b) Professional associations that transcend by issuing resolutions and accounting standards which may become mandatory, but are generally accepted in accounting practice; which are usually consulted by government agencies and also maintain contact with other associations from various countries and integrate to supranational organisations to keep abreast of trends and to assess their adaptation to own accounting models.
c) Audit firms, because the provide a forum where professionals express their opinions and influence to define accounting systems under the greatest amount of resources they can devote to aspects of standardisation or accounting research, as it is the main auditing firms operating in the world.

Training Subsystem provides essential human factor, for the proper development of accounting activities, to the other subsystems.

It offers the intellectual foundation to prepare the accounting standards to the Regulator Subsystem and according to the environment in which it will be implemented; it delivers the conceptual base, critical skills and knowledge of accounting problems to the Accounting Principles Subsystem, so the fundamental guidelines may be directed to meeting objectives assigned to the accounting information.

Likewise, it provides the professional subsystem with agents specialised in accounting, who evolve according to the needs, ensuring their qualification certify the preparedness level so obtained.

Significant differences are appreciated in this subsystem worldwide, between sectors –public or private– in charge of training, characteristics of those teachers responsible for such training, the role of international accounting in university curricula and the level of collaboration between the university and the company.

Also, postgraduate training shows differences in the concerns presented by companies to train new employees in the accounting field, professional recycling, role of auditing multinationals in accounting education and about the model applied to obtain the necessary professional qualification to practice audits.

It is worth mentioning as example that the period of practical training is higher in Britain, for their Chartered Accountants, than the one for Certified Public Accountants graduating in the United States, where they concentrate not only on the auditing area but on tax issues as well.

Jarne's Accounting Principles Subsystem is important for the present research because it recognises those applying in a particular area are not only influenced by the specific characteristics of those accounting system where they belong, but those reflect economic, social and, largely, cultural differences.

Such cultural impact promotes the existence of valuation rules and common information to be understood and interpreted not in the same way in different countries, and that leads to officially allowed issues not necessarily occur as planned in practice.

These differences are accentuated, or aligned, in the world according to whether there is one or more regulatory bodies, to the range of businesses –broad or narrow– using certain valuation practices and, among other circumstances, because to obtain capital markets efficiency the Information Practices concerning its format become less relevant than most Valuation Practices.

Thus, criteria to consider how differentiation is made operational between Valuation and Information Practices show that, in the first ones, application of a specific practice affects with a different value on a given account.

Meanwhile, it will consist of an Information Practice where the above does not happen or if one can explicitly relate that to information, something that demands clarity when referring to the international accounting harmonisation to determine whether the concept is linked to the harmonisation of Information or Valuation Practices.

Consequently, the Valuation Practices Subsystem is based on the importance of the practices from the accounting information point of view, those being decisive in shaping the flow of business information to externals on issues related to debt, assets –fixed or intangible– and other rights, obligations and changes in the equity structure that reflects the objective criteria followed in the process of recognition, measurement and accounting valuation for inclusion in the financial statements and reports in monetary terms.

Finally, the Information Practices Subsystem allows analysing the most significant differences providing accounting information to the outside, either voluntarily or to comply with current regulations, noting quantity, format of the information, its regularity and the mechanism used to communicate that.

Since each subsystem interacts with each other, developing its own activity and defining the overall performance of the accounting system as a whole, its structure allows particularised analysis at groups of countries level, according to the similarity in each of the subsystems and observing differences in each.

To display the homogeneity or heterogeneity existing among accounting systems practiced in the respective countries and group them according to their similarities, the author used the analysis of multidimensional scaling (MDS).

Tables 1.2 to 1.7 show nine countries, from the sixteen included in the sample used in the present thesis, belong to specific groups. Jarne's document did not include seven: Belgium, India, Korea, Netherlands, Philippines, Thailand & Taiwan and China is represented by Hong Kong in these tables. First, on Jarne's Regulatory Subsystem:

GROUP I	GROUP II	GROUP III	GROUP V
Canada	France	*New Zealand*	Japan
China	Germany		
Sweden	Portugal	GROUP IV	
United Kingdom	Spain	-	

Table 1.2 Sample countries in the Regulatory Subsystem

Groups I and IV identify countries where the influence of the external agents in accounting regulation was significant, still well below that in other groups. Group II includes those showing a difficulty for those affected by the standard may give their opinion before the rule takes effect.

Specific working groups for the development of a common standard exist in Groups I, III and IV, compared to the non-existence of them in Group II, while an Accounting General Plan was common to Groups II and III.

The influence of the private side, to comply with accounting rules, was significantly higher in Groups III and IV than in the other two groups while financial statements formats are reported by certain accounting rules in all groups except fourth, where such formats are not normatively set.

It is relevant to note that Group III was assigned specifically for New Zealand –a country not included in the present research sample– because, as explained by the author (Jarne, 1997, p. 130), a link among agencies responsible for regulating the stock market on accounting issues was clearly manifested, opposed to the limited importance of the linkage in the other groups.

As a corollary two fundamental trends are observed in the Regulatory Subsystem: That of a typical accounting system of the European mainland, with regulation emerging from the government, and well identified in the countries of Group II, and another one, Anglo-Saxon, where private sector participates more and is represented by the countries of Group I.

Accounting Principles Subsystem shows the following groups:

GROUP I	GROUP II	GROUP III	GROUP IV
Canada	France	*USA*	United Kingdom
China	Germany		
Portugal	Japan		
	Spain		
	Sweden		

Table 1.3 Sample countries in the Accounting Principles Subsystem

These new groups reflect only one country in the third and another one in the fourth ones, mainly because discreetness is not hierarchically located among the most important principles in both countries, as is the case with the nations of the other groups.

In the United States, accounting principles are mainly defined by the resolutions of professional bodies; consistency, objectivity and relevance principles are critical in the development of accounting information.

Additionally, the true and fair image is not understood only as the fulfilment of the statute but as the development of useful information for decision making, even where the application of prescriptive accounting principles might not be a priority.

In the UK, meanwhile, acceptance of the accounting profession when defining a GAAP is essential and principles are defined by the Companies Act and resolutions of professional organisations, with no hierarchy in their application thereof.

Countries in Group I show a tendency to prioritize the discreetness principle of prudence –by countries such as Canada and Portugal– but there is little transcendence of the Commercial Code as a source of accounting principles, compared to the greater importance of the resolutions from the professional field, and substance prevails over form.

True and faith image interpretation –as useful for decision-making or as reality of substance over form– is not understood in those terms in Group II countries, which crowds most of the countries in the sample. In Group III, the expression is not associated with regulatory compliance or accounting principles and it is not a priority on the implementation of other accounting principles, as is the case in the other groups.

Two trends are observed in the Accounting Principles Subsystem: The first one show the Anglo-Saxon approach prevails in Groups I, III and IV, the accounting profession is relevant when setting GAAP while the second trend corresponds to Group II, where more government regulation and strict application of GAAP is reflected.

No countries, in the present thesis sample, are shown in Groups III, IV and V for the Professional Subsystem but the activity of professional organisations in developing and issuing accounting standards is important. Such organisations also assume professional control functions in Groups II, III and IV.

GROUP I	GROUP II	GROUP III	GROUP IV	GROUP V
Canada	China			
Japan	France			
Spain	Germany			
	Portugal			
	Sweden			
	United Kingdom			

Table 1.4 Sample countries in the Professional Subsystem

Rules of professional ethics and formats to present audit reports are rigorous in these three groups but more flexible in the last two, while in Groups I and II a requirement of accounting audit applies based on the size of the company.

Condition mentioned at the end of last paragraph exists because the role of the auditor is valued as a means of protecting creditors, safeguarding true and fair image and compliance of legality, with the presence of multinational audit firms being very important.

In short, the Professional Subsystem does not accuse significant differences between Groups I and II but the accounting profession denotes a higher development than that identified in Group III.

GROUP I	GROUP II	GROUP III
China	Canada	Portugal
	France	Sweden
	Germany	United Kiingdom
	Japan	
	Spain	

Table 1.5 Sample countries in the Accounting Training Subsystem

The Accounting Training Subsystem reflects the cultural importance of early preparation to exercise the accounting profession but, even more important, includes relevant aspects like having to assess the professional expertise resulting from the inherent periods of education, assimilation of codes of conduct and ethics, practical training and necessary evidences to certify competence in the matter, aspects which cause references to accounting professionals in certain countries be linked directly to auditors.

Qualities that clearly identified countries in each group allow grouping them into three divisions.

Remembering China is represented herewith by Hong Kong, first group shows greater participation of public universities in professional accountants training; in a preferred valuation of teaching, versus research, in universities; in the elaboration of projects within the university aimed at the business sector in addition to usual accounting training programs in companies and recognition by an official body of the professional qualification besides the need of a degree in business studies.

In Group II, it is not apparent teachers impart classes in several universities or the existence of orders from the business sector to college. In addition, firms have no accounting training or retraining programs and several years of minimum experience are required to be able to audit, while the recognition by an official body is also needed.

Group III highlights the existence of private financing for researching; a greater incorporation of accounting programs in firms and that among those countries, a minimum age for obtaining professional qualification is not mandatory, although business studies are a requisite.

European countries conform Group II –but it integrates Canada and Japan, culturally distinct between themselves and from European entities– and the third group is of the Anglo-Saxon type, although it includes continental European countries as well.

The Valuation Practices Subsystem includes no countries, from the sample in the present thesis, in Groups I, IV & V:

GROUP I	GROUP II	GROUP III	GROUP IV	GROUP V
	Canada	France		
	China	Spain		
	Japan			
	Portugal			
	Sweden			
	United Kingdom			

Table 1.6 Sample countries in the Valuation Practices Subsystem

Group II uses evaluation criteria where development costs are activated selectively; WAP and FIFO are used for valuing stock outputs; positive foreign exchange differences are recognised as income in the period where they arise; operating and financial lease differs and lessor is the one recognising the asset in his receivables while the percentage of completion method is used in the recognition of long-term contracts.

Additionally, corporate taxes are charged to expenses for the year; valuing assets under a law is not recognised and the effects of changes in accounting principles on income and equity should be informed in the accounting report.

In Group III financial expenses are incorporated in the assets value and are valued at the acquisition price; there is little acceptance of LIFO method to value stock outputs; positive foreign exchange differences are deferred to the moment the corresponding accounting item expires.

In this third group no distinction exists between operating and finance lease while the lessor keeps the leased good in his assets; it is allowed to reflect deferred tax assets only if their realisation is assured; negative goodwill may be recognised, preferably as a provision for risks and charges or reserves and assets revaluation under a law is accepted.

As a conclusion, there are actually two representative models of the Valuation Practices Subsystem, the Anglo-Saxon one integrating countries in Group II and the one used in the countries of Continental European area.

Variables used as determinants for classifying countries in the Information Practices Subsystem were a hundred and thirty-three and determined the formation of the following 4 groups:

GROUP I	GROUP II	GROUP III	GROUP IV
China	Canada	Japan	*New Zealand*
France			
Germany			
Portugal			
Spain			
Sweden			
United Kingdom			

Table 1.7 Sample countries in the Information Practices Subsystem

Japan, in Group III, could have been included in Group I, but it shows significant differences by not including information on deviations from the accounting principles and by not breaking down stock by type of product.

Japanese practices, as well, include not providing information about the conversion methods used; not presenting reconciliation between book and taxable income, and showing little environmental information, among others.

Group I shows the maximum detected level of information regarding accounting principles, tangible and intangible assets, investments and practically also in relation to currency differences being disclosed, and by differentiating tax expense in the profit and losses statement.

Cash flow, in that first group, is disseminated as well as the consolidated group accounts, referring reasons for excluding any subsidiary where applicable; it is usual information is segmented, mainly the sales one and, on a voluntary basis, significant environmental information is provided. Format and content of financial statements is rigid.

Something similar to what happened with Group III happened with New Zealand in Group IV, which could be included in Group II but which differs by not quantifying the effects of deviations from accounting principles; disclosing cash flow, segment information being transcendent, particularly for sales and results by geographical areas and categories as well as forthcoming interim reporting.

Group II generates information on accounting policies, plant and equipment, intangible and stock as well as about treatment and methods to recognise foreign currency in financial statements; it is not usual to include information relating earnings per share and cash flow statements, added value or equity variation reports are not developed; group information by headquarters which is, in turn, a subsidiary of another parent company is not developed, nor segmented information of any kind or intermediate and environmental information is disseminated.

Information Practices Subsystem includes, in Group I, countries with a higher level of information, followed by Japan, with the already mentioned differences, and leaves in Groups II and IV those with lower levels.

Jarne's research classified accounting systems globally (Jarne, 1997, p. 151-159) and, as a consequence of the individualised study of each subsystem discussed in the previous pages, integrated 6 groups:

a) The Continental European model, so named because it consists mostly of countries in that geographic area.
b) The American Model, with high presence of countries in that continent.
c) A Japanese Model, which it is a variant of the Continental European, with specific characteristics that keeps it away from the American regarding pressure in terms of external agents on accounting regulation, in here being the regulatory process accessible to views of interested parties; where obtaining true and fair image is not a priority to apply GAAP and where there is no need for aptitude tests or specific degree to act as auditor, even where accounting education is more in tune with social reality than in Continental European Model, among other differences.
d) A New Zealand Model, which arises from a branch of the American, but differs from that one because there is a ruling link between accounting standards and stock market regulators needs as well as to a General Accounting Plan –which had no place in the American model, due to the existence of an accounting regulatory body– and because a different priority is assigned to the discreetness principle and associates true and fair image with prior accuracy and objectivity, among others.

e) The British Model, separated from the Continental European by peculiarities, such as the absence of a General Accounting Plan –which is mostly present in the Continental European– and because accounting regulation is not based on the existence of an explicit set of GAAP and auditing is seen by the company with limited utility, in addition to that in this country university education is in tune with social reality, among other differentiating concepts.

f) A Mexican Model which, despite similarities to the American, is mainly broken down by issues such as the failure to define the format of the annual reports in the accounting rules or linking true and fair image to the concept of accuracy, objectivity and compliance with the law.

To complete this section, it can be stated that it is desirable to deepen the analysis of the cultural differences in the countries of the sample taking all aspects included in the following table:

Internal Agents	**External Agents**	**Accounting Subsystem**	**Accounting System**
Tax influence	**Legal System**	**Regulatory**	**Continental European**
Information users	**Finance supplier**	**Accounting Principles**	**American**
Profession development	**Nationalism**	**Professional**	**Japanese**
Education stage	**Business organisation**	**Accounting Training**	**New Zealand**
Accounting objectives	**Stock market stage**	**Valuation Practices**	**British**
	Political system	**Information Practices**	**Mexican**
CULTURAL FACTORS			

Table 1.8 Accounting Systems factors

1.3.2 Sidney J. Grays's contribution.

Arguably the first important research, among those linking accounting to culture, is Gray's (1988) work, who proposes the existence of four accounting values: Professionalism versus Statutory Control; Uniformity versus Flexibility; Conservatism versus Optimism and Secrecy versus Transparency, unwrapped on opposite poles, forming the so-called "accounting subculture" which uses the first two regarding authority and enforcement of accounting practice while the remaining two relate to the measurement and disclosure of accounting information, both groups at a country level.

Extending Hofstede's model, Gray considers accounting values and systems, as well as their links to societal values and institutional norms, to posit cultural factors directly influence the development of accounting information at a country level (Doupnik & Tsakumis, 2004).

However, Gray initially did not conduct empirical tests to support his hypotheses and an early attempt to do so (Eddie, 1990) used an index of accounting values for thirteen Asian-Pacific countries, to then correlate them with Hofstede's cultural dimensions, but even where the predicted signs of association were confirmed, the accounting values constructs and their method of measurement were not rigorous and had no independent validation.

So other early researchers (Perera, 1989; Doupnik & Salter, 1995; Salter & Niswander, 1995; Gray & Vint, 1995; Zarzeski, 1996; among others) examined, at the end of last century, the Hofstede-Gray model to verify the statement about a strong positive relationship between conservatism and risk elimination, opposite to a weak relationship with the individualism and masculinity cultural variables.

Perera (1989) argues accounting standards developed in countries under an Anglo-American cultural environment might face relevance problems when applied in countries under a different cultural environment. Doupnik and Salter (1995) empirically analyse the interrelationship between environmental factors –cultural and institutional– and accounting, and show how both factors contribute to the accounting diversity, institutional factor being the most important one for them.

Salter and Niswander (1995) then used a regression analysis to test Gray's hypotheses, holding Hofstede's cultural dimensions as the independent variables, and contrasted the impact of cultural values on the accounting practices of different countries, evidencing the high explanatory power of the Gray model, claiming that it is possible to explain, with such a model, differences existing among accounting systems, which largely explains the differences in accounting practices.

Gray & Vint (1995) developed a paper on the results of empirical tests of the relationship between culture and accounting disclosures in an international context, covering 27 countries, while Zarzeski (1996) developed an in-depth observation on how accounting practices are derived differently between cultures due to the way business relationships evolve across various cultures.

Some other important research examples exist, like one (MacArthur, 1996) which deals with the influence of culture on the comments made by corporate managers, in connection with the E32 (Comparability of Financial Statements) format issued by the International Accounting Standards Committee; the one prepared by C.B. Roberts and F.B. Salter (1999) analysing the factors that help explaining internationally attitudes of accountants in relation to what would have coveted uniform accounting rules.

There is another one published by T. S. Doupnik y T. Richter (2004) examining the impact of culture on the interpretation of probability expressions used in the International Financial Reporting Standard N° 9 as the deadline for the recognition of accounting items as assets, liabilities and income increases or decreases.

Above mentioned investigations, among many others, prove the study of relationships between accounting and culture is not a new or small issue, but one that has been researched since the last century, which prevents the issue of disinterest in the chosen topic and the lack of literature on this subject.

So Gray was one of the first researchers to explore how accounting differences at the international level –in terms of corporations financial reporting– could be explained and predicted from the differences in cultural factors, in order to comply with the initial purpose of providing a model linking culture with the development of accounting systems.

Based on the initial research of Hofstede (Hofstede 1980, 1983), Gray believed that if the guidelines on societal values were related to the development of accounting systems, at the level of the respective subculture, considering these values permeate the social system of any nation, it could then be hypothesized that there would be a close link between cultural areas and patterns of accounting systems internationally.

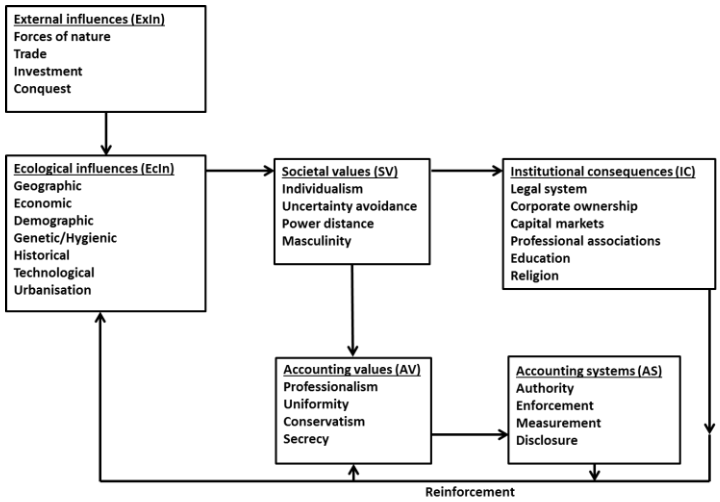

Figure 1.9 Culture, Societal Values and Accounting Subculture

To advance in the search for such a relationship he built the model shown in Figure 1.9, based in the one reproduced in Figure 1.3 of this thesis, exemplifying societal values are determined by ecological influences and modified by external influences such as forces of nature, trade, investment and conquest.

Societal values have institutional consequences that result in legal and political systems, in the nature of capital markets and various corporate ownership structures, among other things, to strengthen both the ecological influences and societal values, as reflected in the table in the previous page, where the level of the accounting subculture is reproduced.

Thus, it is anticipated that attitudes or accountants' values systems are related and stem from societal values and that these values, in turn, impact the accounting systems.

Borker (2013) states Gray's application of the Hofstede dimensional indices has led to extensive discussion, testing and application –in addition to those who started it last century– by Hope in 2003; Doupnik & Tsakumis, in 2004; Chanchani & Willet in 2004; Finch in 2009 and Buys & Schutte in 2011, among others.

There is a general notion that societal values lead to the development and maintenance of institutions within a society, including educational, social, and political systems, and legal, financial, and corporate structures.

Once in place, these systems reflect and reinforce societal values, and tend to be stable and remain in place, except where changes are caused by the major external factors mentioned in figure 1.9.

Gray identified four key accounting values or dimensions (Gray, 1988) which might be used to define a country's accounting subculture:

a) Professionalism versus Statutory Control. Refers to professional judgment and self-regulation in contrast to compliance with rigid legal requirements and legislative control.
b) Uniformity versus Flexibility. Refers to the level of enforcement of standardized and consistent accounting practices and its consistent use over time, instead of flexibility applicable to the particularities of individual companies.
c) Conservatism versus Optimism. Refers to a vigilant approach to accounting measurement, to handle uncertainty on future events, as opposed to a more optimistic and risk-taking approach.
d) Secrecy versus Transparency. Refers to confidentiality and the constraint of disclosure of information, to only those who are closely related to management and financing, as opposed to a more transparent and publicly accountable approach.

As previously stated in this thesis, it is clear that difficulties faced by the international standardisation process for accounting standards are due largely to the different economic and social realities that exist in each country and the various accounting systems that simultaneously operated in the world, responsive to such differences, despite which one could form clusters of related countries based also on the above mentioned values.

Gray (1988) offered four hypotheses to explain the relationship between his own culturally based accounting dimensions and Hofstede's original four cultural value dimensions:

a) Hypothesis I. The higher a ranking in terms of individualism and the lower the ranking in terms of uncertainty avoidance and power distance, the more likely the country is to rank highly in terms of professionalism.

b) Hypothesis II. The higher a ranking in terms of uncertainty avoidance and power distance and the lower the ranking in terms of individualism, the more likely it is to rank highly in terms of uniformity.

c) Hypothesis III. The higher a ranking in terms of uncertainty avoidance and the lower the ranking in terms of individualism and masculinity, the more likely it is to rank highly in terms of conservatism.

d) Hypothesis IV. The higher a ranking in terms of uncertainty avoidance and power distance and the lower the ranking in terms of individualism and masculinity, the more likely it is to rank highly in terms of secrecy.

Gray argues that the most important societal values, at the accounting subculture level, would be the Uncertainty Avoidance Index (UAI) and Individualism (IDV), while the Power Distance Index (PDI) and Masculinity (MAS) would only be significant to some degree, and further relates that MAS would be even less important in the accounting system (Gray 1988, p. 11).

Borker (2013) cites that Baydoun and Willet summarised, in 1995, the relationships between each of the Hofstede cultural dimensions and Gray's accounting dimensions by using a plus sign (+) to indicate a "direct relationship" and a minus sign (-) to indicate an "inverse relationship."

A question mark was used to indicate that the nature of the relationship is indeterminate. These direct and inverse relationships between the Gray hypotheses and the Hofstede dimensions are summarised in Table 1.9:

	Power Distance PDI	Individualism IDV	Masculinity MAS	Uncertainty Avoidance UAI
Conservatism	+	-	-	++
Uniformity	+	--	?	++
Professionalism	-	++	?	--
Secrecy	++	--	-	++

Table 1.9 Relationships between Gray's Accounting & Hofstede's Cultural dimensions.

The relationship between Gray accounting value dimensions and Hofstede cultural dimensions was expanded to include links to Hofstede fifth and sixth dimensions (Borker, 2013), so table 1.10, below, combines linkages of Gray dimensions to the Hofstede values of Pragamatism, in there referred to as Long Term Orientation (LTO), and Indulgence versus Restraint (IVR) with linkages to the original four Hofstede dimensions.

	Power Distance PDI	**Individualism IDV**	**Masculinity MAS**	**Uncertainty Avoidance UAI**	**Long-Term Orientation LTO**	**Indulgence vs. Restraint IVR**
Conservatism	+	-	-	++	+	-
Uniformity	+	--	?	++	+	-
Professionalism	-	++	?	--	-	+
Secrecy	++	--	-	++	+	-

Table 1.10 Expansions of Hofstede-Gray Relationships

Gray (1988) did not consider the fifth dimension of Hofstede (PRA) in his research and he also reached its conclusions without any empirical evidence but Lainez & Gasca (2006) cited a number of empirical studies have sought to establish the significance of the association between Hofstede's cultural values and Gray's accounting values.

In addition to those previously mentioned in this thesis, other researchers have focused on their relationship to valuation and disclosure practices as well (Pourjalali and Meek, 1995 and McArthur, 1996).

These studies have found that Gray's theoretical model contributes statistically significant explanatory power to both areas.

Once it has been accepted that culture influences on accounting practices, it is easy to understand the amount and type of information disclosed by firms varies from country to country as it also influences their accounting systems.

But harmonising accounting practices, to minimise such variations and improve financial information comparability at the international level, demands countries to abandon their accounting traditions, which might be indeed a major obstacle.

Martinez-Conesa and Ortiz-Martinez (2004) stated it is not accounting diversity which encourages higher levels of uncertainty and neither will it be minimised by avoiding it rather than correcting it nor using less biased ratios such as the enterprise value/EBITDA.

They pointed out accounting information is the result of a communication process, affected by an environment that causes specific aspects in the financial reports in response to the requirements of their most powerful users –what Gray and Perera called "accounting culture"– and these aspects denote predetermined behavioural characteristics, a special conceptual framework and a particular accounting terminology, so that different accounting standards introduced bias in the international financial analysis, but those only represent one of the factors of diversity.

Such factors of diversity in the financial analysis may be grouped in the following three:

a) Country factor, including variables related to regulation, level of competition, social and financial systems and macroeconomic variables such as inflation, growth, interest and exchange rates, among others.
b) Sector factor, concerning structural conditions imposed by the company's activity and economic aspects, like the cycle in which the sector is located.
c) Accounting diversity factor, this takes into account differences in accounting standards, different conceptual frameworks and the operating model.

Effect of the three factors must be differentiated by the financial analyst because, as the authors mention citing Choi *et al*. research in 1983, p. 126, accounting figures reflect only "numbers", meaning and importance of which depend on the environment those are extracted from and on the relationship between values and the underlying economic phenomenon, the latter being the really interesting concepts.

Paraphrasing Blake's work in 1990, p. 28, they also express culture and legal environment in a country can have a bigger impact, on the meaning of accounting values, than distortion caused by different accounting methods and they pointed out there are interpretation problems for the analyst where nature and content of the information can only be surpassed with difficulty, like those concepts underlying financial statements preparation.

Gray (1988) reported accounting values differ in valuation and disclosure practices, linked to conservatism and secrecy, and pointed to different associations between the accounting and cultural values cited by Hofstede so, culturally, it is advisable –for the already mentioned purpose in the present thesis– to focus only on disclosure practices.

Lainez & Gasca (2006) used the Hofstede-Gray model and empirically generated a dendrogram to distinguish high degree of similarity exists among some of the countries included in this thesis sample: the UK, Holland, Germany, France and Sweden. Similarly, marked disparity of criteria occurs between those countries and other EU member states included in the mentioned sample, comprised of Belgium, Spain, and Portugal.

Then, on the basis of cluster analysis, they identified two areas of influence, grouped the first five above mentioned countries in Group I and the rest in Group II and they realised firms located in Group I countries disclose voluminous amounts of information concerning their accounting practices, tangible fixed assets, intangible fixed assets and inventories, as well as foreign exchange differences.

These firms in Group I also generally prepare and disclose a cash-flow statement. Furthermore, they offer a considerable amount of segmental reporting, especially with respect to sales. All sample firms in Holland provide segmental reporting, and a significant share of firms operating in Germany (9), France (9), the UK (8) and Sweden (8) also disclose this type of information.

Group II firms disclose information with respect to accounting criteria, tangible fixed assets, intangible fixed assets and inventories, as well as foreign exchange differences. Similarly, they present a cash-flow statement and, to a lesser extent, report the chart of annual financial changes (all of the Spanish firms prepare this chart). Some Group II firms present segmented information with respect to sales.

This is the case in Belgium (6), Spain (7), and Portugal (7). Firms in Belgium and Spain report some environmental information, though only one Portuguese firm does so.

All of the companies in Group II appear to attach limited relevance to information on their employees, however, and they disclose less information of this kind than do firms in Group I.

They also found Firms in Group I countries provide much higher levels of disclosure than do firms in Group II countries.

From a cultural perspective, Group I countries score highly on individualism and give less importance to the avoidance of uncertainty and power distance.

This may lead them to disclose financial information in a more transparent form, in line with Gray's model (1988).

Firms in Group I countries, particularly those where feminine values predominate, are also more willing to disclose a large volume of financial, social and environmental information.

In contrast, firms in Group II countries are characterised by a greater tendency towards confidentiality and secrecy. These are countries in which masculine values tend to predominate, as does the desire to avoid uncertainty and power distance. Such countries also place a lower value on individualism.

Five years after the previously resumed Lainez & Gasca's research, Nazh (2011) shared a study using 498 firm-year observations from six countries for the period between 2004 and 2006 and suggested culture still played a role in the financial disclosure levels of companies even after the adoption of IFRS, although the level of disclosure increased in all countries examined following the adoption of IFRS.

So it was clear that the use of the same accounting standards did not completely eliminated the differences in disclosure and companies continued to disclose information in accordance with their cultural background, whether they operate at the micro level, like countries under the influence of Anglo-American practices, or macro level, comprising countries under the influence of Continental Europe practices.

Following four paragraphs, summarised from Nazh (2011) work, show expected relations among cultural dimensions and Secrecy versus Transparency as developed by Gray, as well as findings of studies that investigate the relation between cultural dimensions and financial disclosure:

a) There is less secrecy and more competition in individualistic societies. Individualistic societies demand accountability and require extensive disclosure relative to collectivist societies, so there is a negative relation between secrecy and individualism and, therefore, a positive correlation with individualism scores and financial disclosure is expected.
Salter and Niswander (1995) report a significant negative relation between secrecy and individualism, while Zarzeski (1996) shows there is a positive relation between individualism and financial disclosure in French, German, Hong-Kong, Japanese, Norwegian, British and US companies.

b) There is a negative correlation between power distance scores and financial disclosure. Gray (1988) proposes that power distance is positively related with secrecy, as less information is expected to preserve power inequalities.
However, Zarzeski (1996) reports positive relation between financial disclosure and power distance and Salter and Niswander (1995) do not find significant relation between power distance and financial disclosure. Thus, research relating to this relation does not provide conclusive results.

c) There is positive relation between secrecy and uncertainty avoidance. Gray (1988) proposes that secrecy is positively related with uncertainty avoidance, as less information is expected to preserve security and avoid conflict and competition. In other words, a negative correlation between uncertainty avoidance and financial disclosure is expected.
Salter and Niswander (1995) find significant positive relation between secrecy and uncertainty avoidance i.e. there is less financial disclosure in strong uncertainty avoidance countries.

Furthermore, according to Zarzeski (1996) a negative relation between uncertainty avoidance and disclosure exists. Again, there is lack of consensus in the direction of relation.

d) There is negative relation between masculinity and secrecy. Gray (1988) hypothesizes that the lower a country ranks in masculinity; it is more likely that it ranks high in secrecy. More caring societies (i.e. feminine societies) will tend to be more open especially in disclosure of socially related information (Gray, 1988). According to Zarzeski (1996), masculine societies are more competitive and competition requires reduced costs, for that reason she expects a positive relation between masculinity and financial disclosure. Her findings support her expectations. However, Salter and Niswander (1995) do not find significant relation between secrecy and masculinity.

Empirical analysis prepared by Nazh (2011) identified there is significant correlation between the cultural dimensions and the disclosure index, except for masculinity. There is significant negative correlation between financial disclosure and uncertainty avoidance and power distance; and significant positive correlation between disclosure and individualism.

He also found significant correlation among the cultural dimensions except for masculinity. Thus his regression analyses were performed by including only one cultural dimension at a time and then he discovered a significant positive correlation between disclosure index and total assets, suggesting that large companies disclose more information in their financial statements.

Furthermore, the significant positive correlation between disclosure index and legal enforcement and market capitalisation indicates that financial disclosure is higher in developed markets.

The significant correlation with net profit margin and disclosure index also points out that, profitable companies disclose more information.

Finally, his research evidenced disclosure in the financial statements improved after the use of IFRS, even though the impact of culture on the disclosure level continued to play an important role, confirming Tsakumis report, in 2007, about uniform accounting standards may not result in similar disclosure decisions and national culture plays a role in accountants' disclosure judgments.

So it was confirmed that the urge to use standards does not necessarily mean that the standards are fully observed, an issue which makes it advisable to now analyse facts related to enforceability and how it may affect different people.

1.4 LEGAL SYSTEMS, CORPORATE GOVERNANCE AND INVESTOR PROTECTION.

For the main purpose of the current research, and following the standards observation comment in last paragraph, it is important to now analyse whether corporate governance –defined herewith, compiling main issues from different authors, as a firms' internal system encompassing policies, processes, and people that serve the needs of shareholders and other stakeholders by directing and controlling management activities with good business practices, objectivity, and integrity– might mitigate earnings management and, therefore, better protect investors.

To do so, it has to be considered as well that sound corporate governance is reliant on external marketplace commitment and legislation, as well as a healthy board culture that safeguards policies and processes.

Reviewing regulatory measures differences in ensuring the investor protection around the world, makes it is advisable to start by recalling there is international consensus on the following seven factors shaping the financial information and the origin of accounting diversity:

A. Legal systems,
B. Political and economic ties between countries,
C. Relations between accounting and taxation,
D. Major financing suppliers,
E. Inflation levels,
F. Accounting profession,
G. Cultural values.

Researchers, like Matoussi & Jardak (2012) citing others, agree there is a strong link between the first and last items above –Legal systems and Cultural values– so investigating the effect of those two on international corporate governance is important because the differences in corporate governance and ownership structure among countries have persisted, now for more than half a century, despite convergence in economies and business practices.

Concentrated family ownership in some European countries (French, Italian, and Spanish firms), strong and powerful managerial control of American and British firms, bank ownership of large blocks in Japan and mandated labour influence in Germany illustrate some of these differences in the ownership patterns in different countries and so in related corporate governance.

The concept of legal systems relates to the operating set of legal institutions, procedures and rules which regulate a given society and those can be grouped into legal "families" –based on their roots; attitudes about the nature of law and its role in the society; the proper operation and organisation of the related system and about the way law should be originated, applied, studied, perfected and taught– with either a common or civil law origin.

However, basic different "families" identify six main styles: Romanistic (French), Germanic (Germanic and Swiss), Anglo-American (English, American); Nordic (Scandinavian); Far East (Chinese, Japanese) and Religious (Islamic, Hindu). But nevertheless, one should consider China and Japan borrowed heavily from the German Code while the religious group is not highly linked to the financial issues reviewed in the present thesis.

A look at the historical development of legal systems proved two derived from different goals: Common law resulted from the victory of private landholders over king and nobility, so laws were adopted to prevent seizure of land by the sovereign in first instance, and judges formed common laws to resolve specific disputes. After that, common law spread to British colonies including the United States, Canada, Australia, and India.

Civil law –the oldest, most influential and most widely distributed around the world– originated in Roman law, uses statutes and comprehensive codes as its principal means of ordering legal material and it relies greatly on legal scholars to formulate its rules, where three civil law traditions may be identified: French, German and Scandinavian.

French civil law –created by Napoleon because he did not want judges to have the discretion to restore feudal privileges after the French revolution– was followed by the French commercial code, written in 1807, and brought by army to Belgium, Netherlands, Italy, Portugal and Spain, among other countries.

German civil law system provides for the independence of judges and the protection of individual property rights, effective in promoting economic growth as may be validated in Japan and Korea, where such a system was borrowed successfully.

The Scandinavian law system –ruling in Sweden, as an example of the countries included in the present thesis sample– is usually viewed as a part of civil law tradition although its law is less derivative of Roman law than it is of French and German traditions.

It has been recognised, in first instance, that where common law applies it contains a set of prohibitions setting limits on individual behaviour and, simultaneously, a high degree of freedom that empowers and strengthens the interpretation of rules –flexible ones usually issued by the accounting profession, for the topic being analysed in the present research– which allows to quickly suit those to the changing environment.

In countries where civil law applies, laws, codes and rules stipulate the minimum standards that determine the expected behaviour of citizens and the accounting aspect often becomes a matter of national legislation, detailing the accounting practices approach in a prescriptive and procedural scope.

So, in short, the so-called Anglo-Saxon legal system is based on jurisprudence –as decisions of previous judges later become the basis of subsequent decision of the judges– and it was implemented in Ireland, Britain, Australia, New Zealand, South

Africa, Canada (except for the Quebec Province) and the United States (except for Louisiana), while countries like India, Nigeria and Pakistan mix it with customary and religious laws.

The Continental law system operates on the various provisions of codified law, systematically compiled, to be interpreted further by the judge in its application and almost 60% of the world's population lives in countries that adhere to this legal system.

Influence of the legal environment, and its enforcement, has been admitted by the founders of the agency theory (Jensen and Meckling, 1976), starting from the premise that the rights of the investors should be protected by regulatory framework, and it has been documented by well-known economists researchers, like La Porta *et al*. (2001, 2000, 1999, 1997, 1996), trying to explain cross-country differences in investor protection from various perspectives.

They stated (La Porta *et al*., 1996) basic origins of laws is clear but laws over time have been amended to incorporate the needs of the adopting countries and quoted, among others, the example of Japan where, after World War II, the American occupying army changed some Japanese laws, although their basic German civil law structure remained.

It was then not an easy task to classify legal systems in a straight way where, as another example, the European Community had issued several directives designed to unify European commercial laws, including some of them pertaining to corporate governance.

While those directives were not mandatory in first instance or the ones with a large impact, namely mergers and acquisitions, were not useful for the purpose of their research, or for the present thesis ones.

However, their work did look at the quality of accounting standards, and so it is important to analyse it here as it is a consequence of the disclosure rules and therefore directly linked to earnings management, and concluded laws differ markedly around the world, though in some places they tend to give investors a rather limited bundle of rights.

It is so particularly in those whose legal rules derived from the common law tradition because they tend to protect investors considerably better than those countries whose laws originate in the civil law, and specially the French civil law, tradition, while the German civil law and the Scandinavian countries take an intermediate stance toward investors protections, even where those last two have the best quality of law enforcement due to their higher income levels.

These authors quoted accounting standards are the lowest in the French civil law countries, where an investor is generally protected neither by the laws nor by high quality law enforcement, and ownership concentration is reported as extremely high around the world –consistent with their evidence that laws, on average, are not terribly protective of investors– and it is a symptom of a poorly functioning capital market.

Their sample included 49 countries classified by four legal origins (English, French, German and Scandinavian): 18 with the English legal origin; 21 with a French origin; 6 with a German origin and 4 with the Scandinavian origin:

- English: Australia, Canada, Hong Kong, India, Ireland, Israel, Kenya, Malaysia, New Zealand, Nigeria, Pakistan, Singapore, South Africa, Sri Lanka, Thailand, UK, US and Zimbabwe.
- French (6): Argentina, Belgium, Brazil, Chile, Colombia, Ecuador, Egypt, France, Greece, Indonesia, Italy, Jordan, Mexico, Netherlands, Peru, Philippines, Portugal, Spain, Turkey, Uruguay and Venezuela.
- German (4): Austria, Germany, Japan, South Korea, Switzerland and Taiwan.
- Scandinavian (1): Denmark, Finland, Norway and Sweden.

A year later they compared external finance –either equity or debt– across 49 countries as a function of the origin of their laws, the quality of legal investor protections, and the quality of law enforcement and found strong empirical evidence that the legal environment has large effects on the size and breadth of capital markets across countries, because "a good legal environment protects the potential financiers against expropriation by entrepreneurs, it raises their willingness to surrender funds in exchange for securities, and hence expands the scope of capital markets" (La Porta *et al*., 1997, p. 1149).

Conclusions showed civil law countries, particularly French civil law ones, have both the weakest investor protections and the least developed capital markets, especially as compared to common law countries.

Then two years later these researchers (La Porta et al., 1999) stated investor protection turns out to be crucial because, in many countries, expropriation of minority shareholders and creditors by the controlling shareholders is extensive, from stealing the profits to asset stripping, investor dilution, overpaying executives and so on. Quoting Grossman, Hart and Moore, they emphasised investor power vis a vis the managers and controlling shareholders, who they called the "insiders", where the first ones' voting rights should be sufficiently protected by law, and the quality of its enforcement, to change directors, to force dividend payments, to stop a project or a scheme that benefits the insiders at the expense of outside investors, to sue directors and get compensation, or to liquidate the firm and receive the proceeds.

However, they pointed out investor protection is deeply rooted in the legal structure of each country and in the origin of its laws while the existing corporate governance arrangements benefit both the politicians and the entrenched economic interests, including the families that manage the largest firms in most countries in the world, so any possible corporate governance reform must circumvent the opposition by these interests.

Additionally, La Porta *et al*. (2001) found out legal protection of investors in a country is an important determinant of the development of its financial markets because where investors recognise a better legal protection they expect more of the firm's profits would come back to them as interest or dividends as opposed to being expropriated by the entrepreneur who controls the firm.

They used company data from 27 wealthy economies to evaluate the influence of investor protection and ownership by the controlling shareholder on corporate valuation, focusing on companies which have controlling shareholders, thereby hoping to keep the power to expropriate relatively constant and considered cash flow ownership by the controlling shareholder as a measure of incentives.

Findings provided support for the quantitative importance of the expropriation of minority shareholders in many countries, as well as for the role of the law in limiting such expropriation and they also found evidence that higher incentives from cash flow ownership are associated with higher valuations.

Those authors assessed the relationship between legal origins and investor protection and their theory has greatly broadened to include many other areas while concluding that common law systems are associated with better economic outcomes, therefore common law countries grow faster than civil law countries.

Nowadays a considerable and influential body of work suggests a country's legal origin is correlated with legal institutions and economic outcomes.

For some years now the World Bank has been interested in what makes countries able to generate growth, enforce investment, secure property rights, and provide public order, so it involved in determining the key characteristics of good laws.

Authors, like Boța-Avram (2013), use governance indicators to empirically test the impact of governance systems and its major characteristics on the strength of investor protection based on data and variables computed within the reports issued by a world-wide recognised professional organisation such as World Bank.

The World Bank "Doing Business" report highlights the significant impact of a country's legal origin on its regulatory scheme and, ultimately, its economic development. It suggested that civil law systems present a handicap for developing countries when compared to common law systems.

That institution made a major contribution by building an initial valuable index of investor protection which measured the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain.

Three dimensions of investor protection are distinguished: transparency of transactions (extent of disclosure index), liability for self-dealing (extent of director liability index) and shareholders' ability to sue officers and directors for misconduct (ease of shareholder suits index).

To construct these indices, the respondents were asked to describe the minimum legal requirement regarding:

A. Who approves the transaction;
B. What needs to be disclosed to the board, shareholders, stock exchange and regulators;
C. What are the duties of the officers, directors and controlling shareholders;
D. How the transaction validity could be challenged;
E. What kind of actions are available if the buyer suffers damages;
F. What needs to be proven under each cause of action;
G. Who has standing to sue under each available cause of action;
H. What is the availability of direct and derivative suits,
I. What access exists to information and discovery rights;
J. What are the potential fines and criminal sanctions?

Currently, the respondents –corporate and security lawyers– base their answers on securities regulations, company laws, civil procedure codes and court rules of evidence and the results are reported for the issues shown in Figure 1.10.

Extent of disclosure Index (0-10)	Extent of shareholder rights index (0-10)
Review and approval requirements for related-party transactions	Shareholders' rights and role in major corporate decisions
Internal, immediate and periodic disclosure requirements for related-party transactions	

Extent of director liability index (0-10)	Extent of ownership and control index (0-10)
Minority shareholders' ability to sue and hold interested directors liable for prejudicial related-party transactions	Governance safeguards protecting shareholders from undue board control and entrenchment
Available legal remedies (damages, disgorgement of profits, fines, imprisonment, recission of transactions)	

Ease of shareholder suits index (0-10)	Extent of corporate transparency index (0-10)
Access to internal corporate documents	Corporate transparency on ownership stakes, compensation, audits and financial prospects
Evidence obtainable during trial	
Allocation of legal expenses	

Extent of conflict of interest regulation index (0-10)	Extent of shareholder governance index (0-10)
Simple average of the extent of disclosure, extent of director liability and ease of shareholder suits indices	Simple average of the extent of shareholder rights, extent of ownership and control and extent of corporate transparency indices

Extent of director liability index (0-10)	Extent of ownership and control index (0-10)
Minority shareholders' ability to sue and hold interested directors liable for prejudicial related-party transactions	Governance safeguards protecting shareholders from undue board control and entrenchment
Available legal remedies (damages, disgorgement of profits, fines, imprisonment, recission of transactions)	

Figure 1.10 WB Minority shareholder protection topics

The ranking of economies on the strength of minority investor protections is determined by sorting their distance to frontier scores for protecting minority investors. These scores are the simple average of the distance to frontier scores for the extent of conflict of interest regulation index and the extent of shareholder governance index.

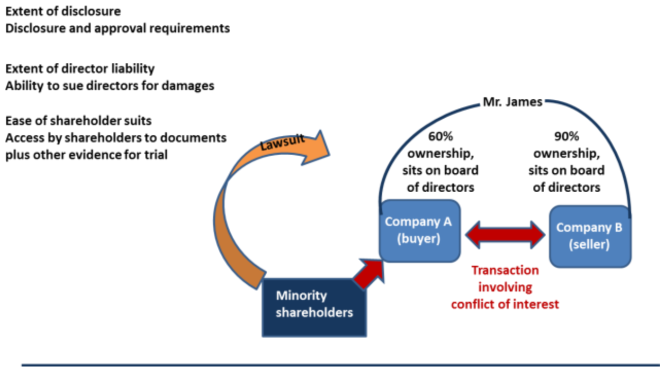

Figure 1.11 WB Transaction example

The most recent round of data collection about this issue was completed in June 2015, using the anti-self-dealing index which focuses on private enforcement mechanisms, such as disclosure, approval, and litigation that govern a specific self-dealing transaction which, according to their authors (Djankov *et al.*, 2008), works better than the previously introduced index of anti-director rights.

Detailed explanation about the business and the transaction assumptions used to make the data comparable across economies may be consulted at: http://www.doingbusiness.org/ methodology/protecting-minority-investors– and this index reports "Protecting Minority Investors" ranks, distance to frontier (DTF) and values for concepts like protection, conflict, disclosure, liability, suits, rights, ownership and transparency, among 189 countries, for the sixteen included in the current thesis sample.

The investor protection index is the average of three indexes: The "level of disclosure index", measured by five variables with higher values indicating greater disclosure; "the level of the director liabilities index", measured by seven variables where higher values indicate greater liability of directors and the "ease of shareholders suits index", composed by six variables with higher values indicating greater power of shareholders to challenge the transaction.

It is important to mention data collected for the World Bank report is based on the most populated city in the country, thus it may not be representative of the legal practices in other parts of the country; it focuses on the specific business form and may not be representative of other forms of business and the transaction described in the case study refers to a specific set of issues and does not represent the full set of issues the business encounters.

Except for Thailand, common law countries in that sample ranked among the first ten, so it is now advisable to recall the previously mentioned four major groups of legal systems reported by La Porta *et al*. (1997) and to identify those nations included in the present study sample as detailed in the following page.

- Common law (5): Canada, Hong Kong, India, Thailand and the United Kingdom.
- French civil law (6): Belgium, France, Netherlands, Philippines, Portugal and Spain.
- German civil law (4): Germany, Japan, South Korea and Taiwan.
- Scandinavian civil law (1): Sweden.

In such a sample, common law countries have the strongest protection of outside investors –both shareholders and creditors– and their systems lead to ownership dispersion and a strong market valuation, whereas French civil law countries have the weakest protection, leading to ownership concentration and, finally, German civil law countries and Scandinavian countries are in between and have stronger protection of creditors.

However, legal origins and quality of laws have not been able to explain all differences in ownership structure and corporate governance models around the world as, for example, Germany and Scandinavia have high quality of laws but do not have dispersed ownership and some authors consider that is because they have strong labour and strong social democratic parties.

Then, according to Licht *et al*. (2005) as well as Matoussi & Jardak (2012), cultural factors seem to be important in explaining the differences in corporate governance and ownership patterns, because "it seems that changing the laws on the books and the act of simply writing investor rights into law is not enough and does not guarantee improvement of corporate governance".

For example, those authors mentioned the cultural environment in East-Central Europe is a potential impediment to change, based on a comparative analysis between the Western European countries and the Eastern European countries after the failure of the communist regimes in 1989-1993.

In that period, the communist countries have strongly-authorised cultural embeddedness and hierarchy, because these values are compatible with low perceived legality, thus achieving social change through legal reform faced serious obstacles.

Additionally, countries such as those in Asia which developed social norms that do not rely on litigation certainly have other mechanisms of governance than those known in the West and, in a previous work; they assessed the impact of cultural factor on disparity on investor protection. These authors showed that cultural environment existing in many developing and transition economies, where investor protection cannot be protected within a proper court system, may lead to a general non-compliance with the applicable law, also accompanied by a high level of corruption or ineffective reform for the control of corruption.

The previous examples prove legal factors alone cannot be effective, because other factors such as culture play an important role, so whether cultural differences in countries have additional explanatory power on earnings management –after controlling for corporate governance and legal systems factors– may be examined in the present thesis as well.

1.5 EARNINGS MANAGEMENT.

Even where there is significant empirical research that seeks to document earnings management in order to determine causes and consequences, most of them have emphasized on specific keys like debt contracting, political costs or on ownership and management incentive compensation plans.

So, as Healy & Wahlen (1999) stated, while it is widely accepted that accounting practices –such as detecting misstatements, preparing financial statements disclosures and other accounting activities– may appear to be equal across the world, as they follow identical or similar standards, there are two methods to categorise earnings management, one being the change in the accrual process and the other one the deviation from normal business activity. Each of those is not only influenced by factors linked to each manager and firm or institutional factors –such as law, market mechanism and regulations– but, as well, by the cultural dimensions in which they are performed which differ from one country to the other.

Initial differences can be seen through the two main accounting models: The Anglo-American one, affecting professional standard setting bodies, emphasising capital markets and relying upon debt financing and equity provided by the public, focuses on true and fair financial statement presentation.

The Continental European Model, with a higher emphasis and reliance upon the government and financial information provided to users, more towards creditors rather than investors, as most entities which use it receive funding from lending agencies.

Notwithstanding such facts, only a few authors directly started in the recent past to associate accounting to cultural country-specific factors and to analyse Asian countries performance.

So the possible impact of culture and accounting values on earnings management remains under-researched and how, why or where they relate is equally important as describing which key variables matter.

Researchers are confronted with an extent body of literature regarding this subject, where many of them consider earnings management to be the single most important item in financial statements, as it may indicate the extent to which a company has engaged in value-added activities and then helps directing resource allocation in capital markets, through the theoretical value of a company´s stock supporting the present value of its future earnings.

Therefore, stock returns / earnings usefulness, relevance and interest to investors and other stakeholders seemed to be an interesting path to be followed by early researchers forty five years ago (Ball & Brown, 1968).

Because while the stock return / earnings –the R^2 of the regression of stock returns on earnings– is not a complete measure, it captures indirectly its ability to facilitate the prediction of future securities return, though it has later been shown it is really hard to lend itself to a straightforward empirical assessment.

It has been said that earnings management has implications for one of the central questions confronted by practicing professional accountants and academic accountants: the influence and importance of accounting accruals in arriving at a summary measure of firm performance, basically considering the opportunities inherent in the current reporting system do not eliminate the usefulness of accounting earnings for valuing shares (Schipper 1989).

So understanding increased earnings represent an increase in company value, while decreased earnings signal a decrease in that value (Lev, 1989) derives, as well, in an interest from company executives to learn about the effect of their financial reporting choices while constituting an explanatory variable to many evaluation models and an accepted support to management strategies –frequently related to earnings, and expressed in terms of so linked objectives– even where it is evident economic and accounting earnings may be different; where there is sufficient awareness about manipulation and fraud in reported earnings as well as little evidence that some firms do so using deferred tax valuation allowances.

It is widely accepted that a framework –which independent auditors, the SEC or the IFRS might enforce– can provide a relatively low cost and credible means for companies' managers to report information about their firms' performance. However, "*because auditing is imperfect, managements' use of judgment also creates opportunities for "earnings management", in which managers choose reporting methods and estimates that do not accurately reflect their firms' underlying economics*" (Healy & Whalen, 1999, p.366).

Previously mentioned documents belong to the past century and reflected a basic structure among several papers dedicated to the earnings management topic but, to have a comprehensive overview of recent research on the matter, this thesis follows, in first instance, the literature review of major accounting journals, from January 2000 to 2006, published in the Hub Research Paper 2008/14 (Verbruggen *et al*. 2008) and later updates it to 2013.

Financial and accounting top journals reviewed were: Abacus; Accounting Horizons; Contemporary Accounting Research; European Accounting Review; Journal of Accounting, Auditing and Finance; Journal of Accounting and Economics; Journal of Accounting and Public Policy; Journal of Accounting Research; Review of Accounting Studies and Accounting Review.

Methodology of the reviewed papers differentiate between the empirical based on financial or accounting data ones and those related to empirical – survey, experiment, analytical models, discussion papers and others, showing 72% of them depended on the first category.

Incentives identified in those papers were classified in five groups: (*i*) Stock market incentives; (*ii*) Signalling / concealing private information; (*iii*) Political costs; (*iv*) Making the CEO looks good and (*v*) Internal motives.

i. Stock market incentives.

Interaction between accounting numbers and stock markets reaction seems to be quite important for earnings management and that is why investors use to rely on the opinions and expertise from stock market analysts in order to try to beat or meet their forecasts, deriving in many papers trying to find out evidence about managers behaviour and achievements through earnings management or expectations management (Bartov, *et al*. 2002), while some other focus on missing an earnings benchmark, because it has negative implications for stock returns as well as CEO compensation (Matsunaga & Park, 2001).

Managers turn to earning management to meet or beat the forecasts and that incentive proved to be stronger where the more analysts agreed in a consensus (Payne & Robb, 2000), showing that where pre-managed earnings were below the forecast, managers used income-increasing earnings management but where the first ones were higher, then managers could choose between income-decreasing or not managing the earnings.

Other researchers have found evidence that firms with small losses and earnings decreases engage in earnings management (Burgstahler & Eames, 2003) and some other have tried to identify firm characteristics associated with that behaviour (Matsumoto 2002) and discovered that those with higher transient institutional ownership are more likely to meet or beat expectations, and so are those who rely heavily on implicit claims with their stakeholders and who are in industries in which earnings have a higher value-relevance, while Ghosh & Moon (2005) concluded that companies showing an increase in earnings as well as in revenues are less susceptible to earnings management.

Aligning shareholder's goals with managers' objectives sometimes demand CEO's and senior management to be compensated by equity incentives, but this kind of decision seems to derive in an increased opportunistic behaviour, as documented by Baker *et al*. (2003), Bartov and Mohanram (2004), Beneish and Vargus (2002), Cheng and Warfield (2005), Kwon and Yin (2006) and Park and Park (2004).

The Hub paper also identified recent research on stock market specific situations, such as seasoned equity offerings; initial public offering and share repurchase and documented corporate executives use stock repurchases as an earnings management tool when earnings are below the level required to achieve the desired growth of EPS.

In order to determine stock market incentives for earnings management, researchers have used analytical models as well, like the Earnings Response Coefficient while others reasoned earnings management emerges relatively easy simply because managers expect their rivals to do so.

ii. Signaling or concealing private information.

A way to achieve certain goals, by explicitly indicating or preventing the disclosure of private information, is definitely a part of earnings management and some articles have been dedicated to that issue, with no obvious links to some other ones specifically discussed in the Hub review.

Allegations –like those relative to Enron, Global Crossing and WorldCom– suggest that failing firms (prebankruptcy ones) may be motivated to engage in fraudulent financial reporting to conceal their distress, as found out by Rosner (2003) who detected the accrual behaviour of those firms displayed significantly greater (material) increases in receivables, inventory, property, plant and equipment, sales, net working capital, current and discretionary accruals in prebankruptcy ongoing-concern years and that they also display significantly more negative changes in cash flows from operations and net cash and a greater disparity between accrual-based net income and operating cash flows.

The signalling hypothesis states firms use share repurchases announcements to signal to the market that their shares are undervalued, but evidence has been found of the fact that analysts fail to recognise the shifts in earnings as optimal tax planning by analysing whether they behave as if they attempt to predict the firm's "correct" or "unmanaged" earnings or whether, instead, they forecast the earnings that management is most likely to report regardless of whether these earnings are correct or incorrect, unmanaged or managed.

Findings show it is sometimes difficult for firms to communicate the goals of their accounting practices to market participants, so when the market does not see through this form of earnings management, these firms might be penalised for their strategic tax planning.

iii. Political costs.

Governmental regulations, tax laws and labour costs, where they are linked to financial reports, have also been analysed as potential sources of earnings management strong incentives, even proven where there are no liquid and efficient stock markets and CEO's are appointed by the government. Chinese companies, for example, have shown interest to show income-increasing earnings management, in order to avoid governmental interference, where that country regulation demanded a minimum 10% ROE for firms wanting to issue bonds or offer shares.

Johnston & Rock (2005) documented income-decreasing earnings management for firms identified as potentially responsible parties (PRPs) under the Comprehensive Environmental Response Compensation, and Liability Act (more commonly known as Superfund in the United States), an initiative which is committed to ensuring hazardous waste sites are cleaned up to protect the environment and the health of all Americans.

It has also been detected there were tax avoidance incentives for the Australian gold mining industry after 1991 and that some firms made discretionary Statement of Financial Accounting Standards (SFAS) 106, related to postretirement's benefits, choices likely to reduce labour renegotiation costs, where they were more unionised, in order to improve future reported income, unless they were constrained by the prospect of potential debt covenants violations.

iv. Making the CEO looks good.

CEO changes have evidenced a trend to downward earning management in the year of senior management changes and upward earnings management in the following years as well as incentives for the new managers to have similar incentives to manipulate the impressions created by graphs (impression management) in the financial reports and in the key financial variables, results being stronger where the CEO change was prompted by a resignation rather than a retirement.

There is also evidence for the retiring CEOs to attempt increasing reported earnings in their final year, not only to receive larger bonus payment –a short horizon hypothesis– but from the desire to later live in style and secure lucrative post-retirement board seats.

Research also added important information by documenting that independent directors and CEO stockholding appear to mitigate the earnings management, while the institutional stockholders appear to exacerbate earnings management in the CEO's final years.

v. Internal motives.

This category relates to earnings management which is not linked to shareholders, government, unions or CEOS but is intra-company and aimed to alter financial reports, or to structure transactions, so that performance objectives are met or budget limits are avoided.

There is empirical evidence, at least from a large multinational corporation, consistency with ratcheting where favourable budget variances result in performance budget increases that are larger than decreases associated with unfavourable variances of the same magnitude, mainly because the cost of reporting positive transitory earnings surprises outweighed the short-term benefits of the current-period bonus, so managers made income-decreasing discretionary accruals to offset transitory earnings surprises beyond the level expected under fixed budgets.

Research about performance incentives has usually related to its measures and pay-performance sensitivities but it had ignored a third significant dimension: the performance standards, which generate important incentives whenever plan participants can influence the standard-setting process.

So distinguishing between “internally determined” standards –those directly affected by management actions in the current or prior year like budget goals or subjective standards– and the “externally determined” ones, that are less easily affected by participants such as peer group or fixed standards as well as cost of capital, is important to then show that companies choose external standards when prior-year performance is a noisy estimate of contemporaneous performance.

Those using budget-based, and other internally determined performance standards, have less-variable bonus pay-outs and are more likely to smooth earnings from year to year, than companies using externally determined standards.

Consistent with the Hub analysis, “Motives” –being the main interest for the purpose of this current study– was ranked first in literature after 2006.

Companies were reported to only engage in earnings management when the benefits of such a behaviour are higher than the risks –companies and CEOs damaged reputation or litigation, as examples– and costs involved, so six broad categories of incentives were now detected: (*i*) stock market incentives; (*ii*) signalling / concealing private information; (*iii*) political costs; (*iv*) making the CEO look good; (*v*) internal motives and (*vi*) cultural impact.

The spotlight has been on those incentives related to the stock market, however, authors for the collected 2000 to 2006 data, as well as those for the updated 2007 to 2013 period, also recognised that most of the journals under consideration relied on U. S. data, an economy known for its widespread ownership and liquid and efficient stock markets, so that in several other countries, where far less listed companies and privately owned companies set the tone, there might be other important reasons for earnings management.

Among the new research since 2007, Japanese companies were analysed and it was noticed that firm managers receiving no bonus adopt income-decreasing accruals and extraordinary items; negative extraordinary items are strongly associated with no bonus payment and the association between discretionary accruals and executive bonus varies depending upon the circumstances of the firm.

Reports also show that more the information asymmetry more will be the cost of capital, so managers manage earnings in order to convey the inside information about firms' prospects and happenings to outsiders and, vis-à-vis firms' relationships with suppliers and customers, there is evidence that industry-level proxies for relationship-specific investments by suppliers/customers are positively associated with the magnitude of discretionary accruals, volatility of earnings, and the frequency of large earnings increases.

Loss of reputation was reported as a factor behind earnings management after identifying either fraud, fraudulent intent or inadequate accounting rules are not necessary requirements, at least not initially, for producing unreliable financial reports.

The fear of a loss of self-esteem and social recognition (status quo), for example, can have a pervasive and distorting influence on cognition and judgement of agents in corporate governance and may result in biased reporting.

The role of information intermediaries on earnings management proved to be relevant as fewer occurrences of earnings management were found for those firms who are briskly followed by equity analysts, more experienced analysts, and high-profile brokers, while firms providing voluntary accounting disclosures appear to be less inclined to make use of manipulation.

Another important issue, reported in recent literature, relates to analysing the legal and regulatory system as well as its link to external corporate governance, showing that common law countries provide the strongest degree of protection for shareholders, supported by the fact that normally, firms in common law countries, where investor protection is stronger, make higher dividend pay-outs, as well as on how females are becoming increasingly represented on Boards.

For instance, as reported by the Census of Women Board Directors of the Fortune 500, in the US in 2012, women held only 16.6% of board seats among Fortune 500 companies, compared with 16.1%, 15.7%, 15.2%, 15.2% and 14.8% in 2011, 2010, 2009, 2008 and 2007, respectively, while in Canada and the UK, women held almost, 14%, and 9%, respectively, of the board seats of those countries' largest corporations in 2009, compared with 13%, and 8.5%, respectively, in 2007 (Equal Opportunity for Women in the Workplace Agency, 2010).

Women held almost 8.0%, 8.5%, and 9.7% of the board seats of the top 300 European corporations in 2004, 2006, and 2008 respectively, compared with 11.7% in 2010 (European Professional Women's Network EPWN, 2010) and Adams and Ferreira (2009) find that female directors can better monitor managers' behaviour through board input, such as board attendance, and are more likely to sit on monitoring-related committees (e.g., audit, nominating, and corporate governance), and affect firm governance in terms of chief executive officer turnover and compensation.

Therefore, female directors can often better improve the earnings quality of firms, as they tend to have better communication skills, hold more informed discussions, and feature better independent thinking, thereby contributing to better monitoring of the managers.

Finally, literature confirms most studies in the earnings management literature have focused on two types of general earnings management: accrual management and the manipulation of real economic activities and recent studies have shown that top managers' compensation is linked to firm performance, which is correlated to greater earnings management.

Focusing on whether and when earnings management takes place, as well as on related motivations, had led to measure total accruals, manager's compensations and job security, lending contracts and regulatory costs and benefits, among other issues, and evidence has been found showing banks use loans loss provisions, while insurers use claims loss reserves, to manage earnings in order to comply with regulatory requirements, but non-financial motives (culture being one of them) has not been identified in previously referred literature.

Accounting theorists have generally evaluated the usefulness of accounting practices by the extent of their agreement with a particular analytic model. The model may consist of only a few assertions or it may be a rigorously developed argument. In each case, the method of evaluation has been to compare existing practices with the more preferable practices implied by the model or with some standard which the model implies all practices should possess. The shortcoming of this method is that it ignores a significant source of knowledge of the world, namely, the extent to which the predictions of the model conform to observed behaviour (Ball & Brown, 1968).

So one important question –in view of the influence and importance of accounting accruals in arriving at a summary measure of firm's performance, but considering resulting accounting numbers could in principle be managed– is whether accounting policymakers should conceive rules in such a way as to avoid opportunities for earnings management.

But then a previous question is advisable: What is the object of earnings management?

Schipper (1989) focuses on disclosure management, in the sense of a purposeful intervention in the external financing reporting process, with the intent of obtaining some private gain, therefore viewing accounting numbers as information and avoiding, for example, difficulties related to distinguishing empirically between investment or production decisions –such as choosing the level of expenditures on research and development or on advertising, adding or dropping a product line or acquiring another firm– that are undertaken purely to maximise share values and those undertaken purely to manage earnings.

She differentiates, within opportunities offered by the accounting system, between managers managing earnings by selecting accounting methods within GAAP or by applying given methods in particular ways, the former quite transparent in the year of change, so it may be flagged by the auditor, while the latter may be harder for an outsider to observe, even where both would not be easily estimated in the years after the initial change.

Gill (2003) recalls that, undoubtedly, the accounting scandals that occasionally come to light, and even more those related to the sub-prime crisis in the US, notably determine public opinion to the opportunistic vision of accounting discretion, but then whatever the kind of motivation anyone has to use management discretion available in determining the outcome, the study of this type of practices is interesting insofar as to identify certain patterns in the accounting policy of the companies. Knowledge of these guidelines, in any event, is useful for different users of accounting information: shareholders, creditors, regulators, auditors, investors, analysts etc.

Among very specific business circumstances giving rise to incentives for management tampering with the stated benefit, either upward or downward, Gill linked examples to some works she cited: the need for government support, where it is necessary to maintain the beneficial relationships between certain limits, quoting Jones work, from 1991, and the issue or change of a particular rule citing Boynton *et al.*, 1992.

She also mentioned a process of redirection referred by Porciau, in 1993; merger and acquisition processes, Take Over Bids, MBO's cited by Perry and Williams, in 1994; IPOs or DPO's mentioned by Teoh *et al.*, in 1998; the need to comply with conditions of loan contracts stated by DeFond and Jiambalvo, in 1994, etc.

However, if the company is not going through special situations which motivate management to carry out a type of accounting policy to increase or decrease the benefit continuously, smoothing benefits –meaning increasing those in some exercise and decrease them in other, in order to minimise fluctuations around a given long-term goal– seems the most reasonable in the long term.

This author uses Beidleman's definition, from 1973, one of the most frequently used in related literature, who stated: "smoothing reported benefits can be defined as the deliberate damping fluctuations on some level considered normal for the business. In this sense, smoothing represents an attempt by the company managers to reduce abnormal variations in profit to the extent permitted by accounting principles".

She prepared the table in the following page to list other documents where aspects of such definition are included, and where *** represents those papers using the same definition; "X" those showing conformity or disparity with it and where cells in blank indicate related definition makes no express reference to those aspects.

That table above synthesises four key aspects and shows whether or not they are incorporated in other definitions found throughout the literature:

a) Smoothing consists in reducing variability of the declared profit. This is one fundamental aspect of smoothing, in which virtually all the papers analysed match.

b) Gill (2003) says Beidleman also points to the need for intentionality by managers. On this point there is no consensus in the literature as some authors consider the possibility that smoothing observed in the reported benefit is not deriving from managers' intentional manipulation but from the benefit determination process itself, so it occurs naturally.

Author (Year)	Damping fluctuations	Manager intention	Normal level	Permitted by GAAP
Ronen & Sadan (1975)	***	X	***	
Barnea *et al* . (1976)	***	***	***	
Ronen *et al* . (1977)	***	X	***	
Imhoff (1977)	***	X	***	
Koch (1981)	***	***	***	
Eckel (1981)	***	***	X	
Lambert (1984)	***	***	***	
Ma (1988)	***	***	***	
Albrecht & Richardson (1990)	***	***	***	
Apellániz (1991)	***	***	***	***
Gabás & Pina (1991)	***	***	***	***
Bartov (1993)	***	***	***	
Ashari *et al* . (1994)	***	***	X	
Fern *et al* . (1994)	***	***	X	
Beattie *et al* . (1994)	***	***	***	
Fundenberg y Tirole (1995)	***	***	X	
Apellániz & Labrador (1995)	***	***	***	***
Carlson & Bathala (1997)	***	***	X	***
Young (1998)	***	***	X	***

Table 1.19 Smoothing definitions on literature (1975-1998)

c) Benefit variability is measured relative to a level considered normal. Notwithstanding researcher ignores what is such normal level and, therefore, needs to make assumptions about it.

d) Finally, she mentions Beidleman notes that smoothing practices comply with Generally Accepted Accounting Principles (GAAP). This aspect delimits the border between what would be legal manipulation and fraud. At this point there are discrepancies and other authors also consider smoothing those practices undertaken outside the regulations.

It is important to mention that smoothing was a term used mainly in papers prepared some time ago, because recent literature considers earnings management as the selection of techniques by the manager for a level of desired benefits desired, using the flexibility allowed by the principles of GAAP, while smoothing is in fact a particular case of earnings management whose main objective is to present less variability on reported profits.

Some assumptions supporting specific types of basic smoothing are mentioned by Gill, citing Hepworth work from 1953:

a) Taxes on profits.
b) Management relation with investors and workers.
c) Damping effect on the general economic cycles.

She, later in her work, differentiates between two kind of benefit management practices: those affecting directly the cash-flow –real earnings management– for example, decisions about when to sell assets and those that affect financial variables without affecting cash-flow directly –accounting earnings management– like some accounting changes or accrual adjustments, affecting temporary recognition of certain income and expenses, as purchases and sales, supplies, provisions for pension funds, asset depreciation, etc.

Within accounting earnings management, manipulation of accruals is less transparent and, therefore, more difficult to observe by third parties than alternatives such as accounting changes, which should be reported in financial statements and, in addition, could not be used as manipulative instrument over several years because those would arouse suspicions of the auditor.

Some very important findings, for the purpose of the present thesis, derived as well from the empirical research by Leuz *et al*. (2003), as they obtained specific scores for earnings management and inherent disclosures, the first ones after computing from 70,955 firm-year observations for fiscal years 1990 to 1999 across 31 countries and 8,616 non-financial firms, with data obtained from the Worldscope Database (November 2000), while the disclosure scores were obtained after classifying the legal origin and legal tradition, based on La Porta *et al*. (1996).

Authors explained a first measure (EM1) for earnings smoothing is accruals, which captures the degree to which managers conceal changes in their company's true economic performance using both real operating decisions and accounting choices.

It is the country's median ratio of the firm-level standard deviations of operating income and operating cash flow, both scaled by lagged total assets: σ(OpInc) / σ(CFO). Low values indicate managers exercise discretion to smooth reported earnings, meaning more earnings management, hence poor accounting quality.

Their research made it easier to verify earnings management relate systematically across countries in association with different levels of investor protection and confirmed earnings management is lower in countries with strong investor protection while countries with weak investor protection generally have poor accounting quality.

Dichev *et al.* (2013), additionally, consider the concept of earnings quality is fundamental in accounting and financial economics; yet there are broad disagreements about how to define and measure it and mentioned, citing Dechow *et al*. work from 2010, that complicating the measurement of earnings quality, archival research cannot satisfactorily parse out the portion of managed earnings from the portion resulting from the fundamental earnings process.

So they decided to try a new data source: a large survey and a dozen interviews with top financial executives, primarily Chief Financial Officers (CFOs), and explained four reasons to such a selection:

a) CFOs are the direct producers of earnings quality, who also intimately know and potentially cater to consumers of earnings information such as investment managers and analysts. They make the key decisions on how to apply accounting standards in their company, and whether to use or abuse discretion in financial reporting.

b) CFOs commonly have a formal background in accounting, which provides them with keen insight into the determinants of earnings quality, including the advantages and limitations of GAAP accounting.

c) CFOs are key decision-makers in company acquisitions –mentioning Graham *et al*. work from 2012– which imply that they have a working knowledge of how to evaluate earnings quality from an outsider's perspective.

d) CFOs have access to much tacit knowledge about earnings quality through their networks of financial executives in their industry and geographical neighbourhood, e.g., from informal conversations about earnings management in peer companies.

To identify managed earnings, there is considerable academic and practical interest in using publicly available data and a related but challenging desire to split earnings (or earnings components) into an innate portion that is beyond the control of the management versus a discretionary portion that can be influenced by CFO decisions.

So, they explained CFOs that academic researchers have struggled for years trying to use publicly available data to identify companies that misrepresent reported performance and prompted them to express, in their view, what are three "red flags" that would help academics detect such misrepresentation.

Their findings showed main CFOs' responses related to GAAP earnings not correlating with cash flow from operations; weak cash flows as well as earnings and cash flow from operations moving in different directions for 6-8 quarters in addition to earnings strength with deteriorating cash flow. Also reports mentioned deviations from industry (or economy, peers') norms/experience (cash cycle, volatility, average profitability, revenue growth, audit fees, growth of investments, asset impairment, level of disclosure); consistently meeting or beating earnings targets (guidance, analysts forecasts) and large/frequent on time or special items, like restructuring charges, write downs, unusual or complex transactions as well as gain/losses on assets sales. The following four most popular "red flags" were detected:

a) Earnings inconsistent with cash flows, meaning trends in earnings that diverge from trends in operating cash flows and pointing out there is still much work that can be done here, especially in the direction of explicitly modelling and exploring the effect of firm growth, given that growth firms naturally tend to have high accruals and weak operating cash flows but not necessarily poor quality earnings.
b) Deviation from norms or peer experience, which include deviations in items such as cash cycle, average profitability, revenue and investment growth, and asset impairments. Authors recalled some of the most celebrated cases of earnings manipulation (Enron, WorldCom), and recommend to think that perhaps a more direct and powerful investigation of this red flag is in order.
c) Miscellaneous signals, a cluster that includes consistently meeting/beating benchmarks earnings, frequent one-time items, lots of accruals and changes in accruals, and earnings patterns that are too smooth for fundamentals.
d) Other signals, related to an eclectic collection, including familiar themes like build-ups in inventories and receivables, large volatility in earnings and lack of transparency in financial reporting. There are also some signals that sound intuitive but have received less attention in the literature, e.g., sudden or frequent changes in management and directors, frequent changes in significant accounting estimates, and "tone at the top."

Xie *et al*. (2003), citing 1998 work by Teoh *et al*., assert that under Generally Accepted Accounting Principles (GAAP), firms use accrual accounting which attempts to record the financial effects on an entity of transactions and other events and circumstances that have cash consequences for the entity in the periods in which those transactions, events, and consequences occur rather than only in the period in which cash is received or paid by the entity.

The nature of accrual accounting gives managers a great deal of discretion in determining the actual earnings a firm reports in any given period. Management has considerable control over the timing of actual expense items (e.g., advertising expenses or outlays for research and development). They can also, to some extent, alter the timing of recognition of revenues and expenses by, for example, advancing recognition of sales revenue through credit sales, or delaying recognition of losses by waiting to establish loss reserves.

They referred to the considerable attention by regulators and the popular press on earnings management as well as to the speech, in September 1998, to lawyers and CPAs from Arthur Levitt, chairman of the Security Exchange Commission committed ‘‘the SEC in no uncertain terms to a serious, high-priority attack on earnings management’’(Xie *et al*., 2003, p. 295), there followed by the formation of a Blue Ribbon Panel by the Public Oversight Board, an independent private sector group that oversees the self-regulatory programs of the SEC Practice Section of the American Institute of Certified Public Accountants.

So they examined the relation between earnings management and the structure, background, and composition of a firm’s board of directors. Their results were consistent with the Blue Ribbon Panel recommendation, indicating that a lower level of earnings management is associated with greater independent outside representation on the board.

The monitoring that outside directors provide may improve when they are financially sophisticated (e.g., experienced in other corporations or in investment banking), while the presence of corporate executives and investment bankers on audit committees was associated with a reduced extent of earnings management.

Finally, their results showed that more active boards, as proxied by the number of board meetings, and more active audit committees, as proxied by the number of committee meetings, were also associated with a lower level of earnings management.

However, some years later García & Gill (2005) showed that to a certain extent an Anglo-Saxon model of corporate governance may turn out to be a failure when used in a different institutional setting. In this sense, they showed that independent experts are inefficient in reducing accounting manipulation in their sample, except when they are designated by institutional directors in the case of Spain. Such evidence is particularly relevant as it relates to a continental Europe context whose characteristics differ substantially from those of Anglo-Saxon countries, mainly the United States and Britain, where empirical evidence has shown effectiveness of the mechanisms of good governance to restrict earnings management practices.

In Spain neither the corporate culture nor the existing regulations have led creating a market of independent experts to provide open and competitive businesses people with the right profile to perform the work in the Anglo-Saxon context is attributed to independent corporate governors.

So these authors concluded, in a later document (García & Gill, 2007), that merely importing the Anglo-Saxon model is probably not the best solution for code-law type of countries, such as Spain because, citing work by Recalde in 2003, Spanish companies have very different governance structures from their American counterparts, with important family and institutional block holders that effectively monitor managers. In short, the establishment of governance mechanisms should be adapted to the context in which they will be implemented.

Following Heidrik and Struggles' report from 2003, they mentioned greater information disclosure requirements might help to promote structural changes in Spanish business culture, leading companies to take more care in the independent directors designation process and these directors to assume their role with responsibility.

In a similar way, Sanchez-Ballesta & Garcia-Meca (2007) used panel data methodology to examine the relationship between ownership structure, discretionary accruals and the informativeness of earnings for a sample of Spanish non-financial companies listed on the Madrid Stock Exchange during the period 1999-2002.

They concluded the proportion of shares held by insiders in Spain is a mechanism of corporate governance that constrains earnings management when insider ownership is below these levels of ownership, but for higher levels of insider ownership this mechanism becomes ineffective.

Therefore, their results confirmed that insider ownership is a mechanism that, in spite of the differences in corporate governance, may constrain discretionary accruals when the proportion of shares held by insiders is not too high.

Nevertheless, when insiders own a large percentage of outstanding shares, they tend to make discretionary accounting choices. On the other hand, ownership concentration does not show a significant association with discretionary accruals.

So again, it was proved that in a country like Spain, with a corporate governance system characterised by low investor protection and high ownership concentration, insider ownership affects both the informativeness of earnings and discretionary accruals. The findings demonstrate that on average earnings are more likely to be manipulated when insider ownership is too high.

Another interesting analysis about differences between Spain, UK and the US was prepared by Garcia-Teruel *et al*. (2010) as they cited some other authors –like La Porta *et al*. as well as Faccio and Lang– and stated Spain is classified as a code law country characterised by weak investor protection, a less developed capital market, a high concentration of ownership and higher levels of earnings management than Anglo-American countries, as referred by Leuz *et al*. in 2003.

Nevertheless, they quoted different studies –from Hung in 2001; D'Arcy in 2001 and Bhattacharya *et al*. in 2003– show that in term of earnings opacity and accounting regulation, Spain occupies an intermediate position between Anglo-Saxon countries and European code law countries, something which supports the informative role of accruals.

In addition, they said, in contrast to the well-developed capital markets in the U.S. or U.K., the financial system of continental European countries, and particularly Spain, is a banking-oriented financial system, quoting Schmidt and Tyrell work from 1997, where most resources are channelled via financial intermediaries, basically the banks. They say that according to 1999 research by Cuñat, public debt in Spanish listed firms represents only 6.3% of all their debts.

This implies that as banks have more re-contracting flexibility and processing abilities over bondholders, there is a more sensitive response to accounting quality in terms of maturity of loans in banks with respect to public lenders, paraphrasing Bharath *et al*.

In addition, Spanish firms, in contrast with U.S. firms, present a very different debt maturity structure, evidencing higher levels of short term debt. Indeed, the mean value for long-term debt (over total debt) in Spanish firms is around 29%, much lower than the 78.54% presented by U.S. firms.

1.6 CULTURE AND FINANCIAL INFORMATION LINKAGE.

For the purpose of the present thesis, pointing out differences –like those commented about Spain compared to UK and USA on corporate governance and earnings management– is very important, but it is even more interesting to examine papers which, additionally, relate culture to the equation.

That is the case of the research prepared by Sandeep & Boonlert-U-Thai (2007), as they linked investor protection and national culture on earnings management for a sample of 30 countries and found out earnings management is negatively associated with outside investor rights, consistent with Leuz *et al*. (2003).

They also found that earnings management is relatively high in countries with high uncertainty avoidance scores while supplementary analysis of earnings management components indicates that uncertainty avoidance and masculinity are associated with earnings discretion but not with earnings smoothing, so they concluded that culture is an important determinant of accounting choice and should be considered by standard setters enacting and enforcing international financial reporting rules.

In their first attempts they tried to include the Schwartz (1992) variables in the analysis, but the sample size decreases from 30 countries to 18, leading to significant loss of power. The excluded countries were characterised by the absence of developed equity markets and insufficient data / noncoverage on databases such as Compustat.

Besides, the Schwartz variables had no explanatory power for the earnings management proxy in the reduced sample; hence they chose to focus on Hofstede's cultural dimensions in their study.

They also considered Gray did not incorporate earnings management into his model, and as a result, the impact of culture on those remains relatively unexplored.

In their reasoning, uncertainty avoidance implies a preference for unambiguity and earnings management could be positive for the following reasons: Strong uncertainty avoidance could lead to a demand for earnings smoothing and earnings signalling, both of which can be achieved through earnings management.

Citing some authors, like Degeorge *et al*., Barth *et al*. and Mikhail *et al*., they added that recent finance and accounting research has demonstrated that in the United States, managers strive to meet or beat earnings thresholds; that investors reward firms that consistently report increasing earnings and that firms reporting negative earnings surprises bear relatively high costs of equity capital.

They considered that if these rewards and penalties are high in strong uncertainty-avoidance countries because people value consistency in firms' earnings streams, then managers in such countries are likely to manage earnings. The relationship between uncertainty avoidance and earnings management is thus an empirical issue.

As well they stated that Schuler and Rogovsky find that individualism is positively associated with the use of pay-for-performance contracts. Thus personal gain is likely to be an important motivator in high individualism societies. They also said prior research on earnings management, e.g., Beneish's, suggests that managers misstate earnings to maximize their own wealth, often at a significant cost to other stakeholders in the firm. Concern for other stakeholders' welfare is indicative of collectivism, not individualism. Accordingly, earnings management is likely to be high in high individualism societies.

Sandeep & Boonlert-U-Thai (2007) stated that because high power distance implies that decision structures in organisations are centralised and that authority is concentrated in the hands of the top managers, as declared by Hofstede, high power-distance countries are characterised by the lack of both leader communication, as referred by Offerman and Hellmann in 1997, and participative leadership, quoting 1999 work by House *et al*.

Prior research indicates a high incidence of earnings management when top managers are powerful. For example, Dechow *et al*. (1995) find that earnings management is prevalent in firms in which the chief executive officer also either serves as chairman of the board or is the firm's founder.

Gray (1988) also argues that information sharing is low in high power-distance societies. For these reasons, they expected a positive relationship between power distance and earnings management.

Finally, masculinity indicates a preference for achievement, assertiveness, and material success, so in high-masculinity societies, according to Hofstede, desirable managerial qualities include decisiveness and competitiveness. The society places high emphasis on performance, and managers hold ambitious career aspirations and prefer to work for prominent companies and earn high salaries.

Masculinity has also been shown to be positively associated with societies' acceptance of aggressive behaviour and consumers' desire to keep up appearances. This suggests that managers in high-masculinity societies are likely to endeavour to report strong profits that beat benchmarks. Accordingly, the relationship between masculinity and earnings management is likely to be positive.

Healy & Wahlen (1999, p.368), with the goal of reviewing the earnings management research relevant to standard setters, changed the previously mentioned question –"What is the object of earnings management"– to "What is earnings management?" and defined it:

"Earnings management occurs when manager use judgement in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers".

Leuz *et al*. (2003) complemented work mentioned in the preceding paragraph and argued that incentives to misrepresent firm performance through earnings management arise, in part, from a conflict of interest between firms' insiders and outsiders. Insiders, such as controlling owners or managers, can use their control over the firm to benefit themselves at the expense of other stakeholders. Examples of such private control benefits range from perquisite consumption to the transfer of firm assets to other firms owned by insiders or their families.

The common theme, however, is that some value is enjoyed exclusively by insiders and thus not shared with non-controlling outsiders.

They also stated that managers and controlling owners have incentives to manage reported earnings in order to mask true firm performance and to conceal their private control benefits from outsiders, while they can also use their accounting discretion to create reserves for future periods by understating earnings in years of good performance, effectively making reported earnings less variable than the firm's true economic performance.

These three authors –their main research interest being quality of reported earnings and investor protection– pointed out that legal systems protect investors by conferring on them rights to discipline insiders (e.g., to replace managers), as well as by enforcing contracts designed to limit insiders' private control benefits and, as a result, legal systems that effectively protect outside investors reduce insiders' need to conceal their activities.

Leuz *et al*. (2003) anticipated earnings management is more pervasive in countries where the legal protection of outside investors is weak, because in these countries insiders enjoy greater private control benefits and hence have stronger incentives to obfuscate firm performance and analysed financial accounting data from 1990 to 1999 for over 8,000 firms from 31 countries and created four proxies, that captured the extent to which corporate insiders use their accounting discretion to mask their firm's economic performance, to measure the pervasiveness of earnings management.

After grouping countries with similar legal and institutional characteristics they identified some of those included in the present research sample:

a) Outsider economies with large stock markets, dispersed ownership, strong investor rights, and strong legal enforcement, which includes the UK.
b) Insider economies with less-developed stock markets, concentrated ownership, weak investor rights, but strong legal enforcement, where Germany and Sweden appeared.
c) Insider economies with weak legal enforcement, like in India.

As a result, they discovered earnings management appears to be lower in economies with large stock markets, dispersed ownership, strong investor rights, and strong legal enforcement an developed four different country-level measures of earnings management that captured various dimensions along which insiders could exercise their discretion to manage reported earnings, focusing on outcomes of insiders' earnings management activities and avoiding the problem that stated accounting rules can be (and often are) circumvented by insiders and hence do not reflect firms' actual reporting practices.

First measure referred to smoothing reported operating earnings using accruals, where insiders can conceal changes in their firm's economic performance using both real operating decisions and financial reporting choices, so a country's median ratio of the firm-level standard deviation of operating earnings was divided by the firm-level standard deviation of cash flow from operations.

Scaling by the cash flow from operations helped them controlling for differences in the variability of economic performance across firms. Low values of this measure then indicated that, ceteris paribus, insiders exercised accounting discretion to smooth reported earnings and changes in short term debt were excluded from accruals because they relate to financing transactions as opposed to operating activities.

The second measure assessed smoothing and the correlation between changes in accounting accruals and operating cash flows, considering, for example, insiders may accelerate the reporting of future revenues or delay the reporting of current costs to hide poor current performance or underreport strong current performance to create reserves for the future.

However, authors cited Dechow (1994) to indicate accounting accruals buffer cash flow shocks and result in a negative correlation between changes in accruals and operating cash flows, so a negative correlation is a natural result of accrual accounting.

Then, they mentioned 1999 work by Skinner & Myers to alert larger magnitudes of this correlation indicate, ceteris paribus, smoothing of reported earnings that does not reflect a firm's underlying economic performance.

For their third measure, named: "Discretion in reported earnings: The magnitude of accruals", they commented insiders can use their reporting discretion to misstate their firm's economic performance. For instance, insiders can overstate reported earnings to achieve certain earnings targets or report extraordinary performance in specific instances, such as an equity issuance.

This one was computed as a country's median of the absolute value of firms' accruals scaled by the absolute value of firms' cash flow from operations. The scaling controls for differences in firm size and performance.

Last measure –Discretion in reported earnings: Small loss avoidance– showed managers have incentives to avoid losses of any magnitude, but they only have limited reporting discretion and are consequently unable to report profits in the presence of large losses. Small losses, however, are more likely to lie within the bounds of insiders' reporting discretion. Thus, in each country, the ratio of small reported profits to small reported losses reflects the extent to which insiders manage earnings to avoid reporting losses.

So this time Leuz *et al*. (2003) cited 1997 work by Burgstahler and Dichev and the ratio of ''small profits'' to ''small losses'' was computed, for each country, using after-tax earnings scaled by total assets and at the end, to mitigate potential measurement error, they constructed an overall summary measure of earnings management for each country.

For each of the four earnings management measures, countries were ranked such that a higher score suggests a higher level of earnings management.

The aggregate earnings management score was computed by averaging the country rankings for the four individual earnings management measures and their regression results showed that earnings management is negatively associated with the quality of minority shareholder rights and legal enforcement.

Conclusions expressed outsiders can only take disciplinary actions against insiders if outsiders detect the private benefits, but insiders have an incentive to manipulate accounting reports in order to conceal their diversion activities.

Thus, authors expected that earnings management decreases in legal protection because, when investor protection is strong, insiders enjoy fewer private control benefits and consequently incentives to mask firm performance are moderated.

Callao & Jarne (2010) questioned whether the adoption of IFRS in the European Union has increased or decreased the scope for discretionary accounting practices by comparing discretionary accruals in the periods preceding and immediately after the regulatory change, using a sample of non-financial firms listed on 11 EU stock markets.

The results obtained show that earnings management has intensified since the adoption of IFRS in Europe, as discretionary accruals have increased in the period following implementation, so the authors reasoned that such a fact may be connected to the differences between IFRS and local standards with regard to the valuation criteria of property, plant and equipment, an item that concerns long-term discretionary accruals.

These results suggest that IFRS have actually encouraged discretionary accounting and opportunistic behaviour, with a consequent impact on the quality of financial information and, because the countries where earnings management has increased the most, with a significant increase for the current, long-term and total discretionary accruals are France and the UK, countries traditionally regarded as representative of the Continental European accounting model, in the case of France, and Anglo-Saxon model in the case of the UK, that allowed the authors to think that the source accounting model is not decisive for the impact of the IFRS on earnings management.

Matters like flexibility, which is often greater than in the previous national standards, the subjectivity implicit in the application of certain criteria such as fair value and the lower level of requirements related to the financial statements presentation format might explain their results.

Examples of options in IFRS are the choice of capitalisation or expensing for interest costs on assets; choice of cost or fair value measurement for classes of property, plant and equipment or for some types of intangible assets; choice of content of statement of changes in equity, no format requirements for balance sheet or income statement, and so on.

Apedzan *et al*. (2014) refer a review of accounting literature has shown that accounting modelling has been a challenge to many accounting researchers as most of the criticisms of prior accounting research work related to modelling are based on model misspecifications and reminded that the time for normative research in accounting has gone for good and, quoting 1978 research by Watts and Zimmerman, it is time towards positive theory in accounting.

They start mentioning that the first attempt at earnings management behaviour was observed by Hepworth, in 1953, who surveyed and documented some of the accounting techniques (smoothing devices or specific accruals) which may be applied to affect the assignment of net income to successive accounting periods. No attempt was however made at detecting income smoothing.

Then they recalled research by Gordon, in 1964, who presented a hypothesis that managers select accounting measurement and reporting rules which smooth reported income. The hypothesis is a classic research and generated reactions and researches in the field of accounting income smoothing.

An operational test of smoothing was suggested by Gordon, graphical representation as follows: for each firm fit a curve to a stream of income calculated two ways, (a) excluding the manipulative variable, and (b) including it. "If the variations of the observations around the curve are smaller in the latter case, income smoothing has been the consequence of transactions in the account".

Citing 1996 work by Dopuch and Drake, authors reminded these two researchers established a sample of twelve firms for which investments in non-subsidiary companies were material over the period 1955-64. Total income and income from non-subsidiary investment activity were plotted for each firm.

Those authors concluded that income smoothing by this means has not been a serious problem with the firms included in their sample, although some of the firms apparently did act to smooth income.

Finally, they said Archibald investigated, in 1967, how and why a group of 55 firms changed from a form of accelerated depreciation to a form of straight-line depreciation for financial and tax reporting purposes, using tables and graphical illustrations and discovered a median improvement of about 10.18 percent in net earnings. He found that 22 of the 55 switch-back firms had lower profits in the year of the change, but offered no conclusion on whether it was meant for smoothing.

Then an important comment about a mathematical model to test income smoothing referred to research by Gordon *et al*., in 1966, who selected the investment credit as the smoothing variable by which to test Gordon's hypothesis that firms attempt to smooth income.

The smoothing hypothesis was tested by considering whether an accounting measurement rule was selected which tended to: (1) adjust the firm's percentage change in earnings per share to the average percentage change in the industry, or (2) smooth the firm's earnings per share toward a normal value, or (3) smooth the firm's rate of return on stockholder's equity.

The introduction of double exponential smoothing to measure the first two criteria above produced more error than it eliminated, thus leaving open to question the validity of their evidence, so results remained inconclusive.

They continued quoting works by other researchers, from 1968 to 1970, where they found that Beidleman was, in 1973, the first to empirically confirm existence of smoothing among US firms. He stated that conventional techniques for disaggregating time-series data may be used to separate the time trend of normal earnings from the random and cyclical factors which are the objects of the smoothing process. That firms whose normal earnings (Et) are expected to change by a constant amount (g) each year can be described by equation (1).

$$Et = (E_o + g_{at}) \quad (1)$$

The normal level of earnings for firms which maintain a geometric progression or constant rate of growth (gr) is described by equation (2):

$$Et = (E_o + g_r)^t \quad (2)$$

The difference between observed earnings and normal earnings as defined represents random and/or cyclical factors and can be used to test for evidence of smoothing by management.

He used least-squares linear time trend regression for firms that were expected to grow at a constant rate using sample of firms which reported at least three discretionary items out of six for ten years or more.

$$E_{it} = a_{ei} + b_{ei}t + \mu_{eit} \quad (3)$$

Similar linear model was used for discretionary smoothing variables (D_{it})

$$D_{it} = a_{di} + b_{di}t + \mu_{dit} \quad (4)$$

Semi logarithmic time trend regression was used for firms that were expected to grow at constant growth rate to test for smoothing using similar models. The test of the hypothesis is based on the correlation between the residuals from equations (3) and (4).

Correlation coefficients and tests of the significance of the relationship between the time-series residuals are obtained by regressing the residuals.

$$\mu_{dit} = a_{si} + b_{si}\mu_{eit} + \mu_{sit} \qquad (5)$$

Student t tests on b_{si} provide a measure of the statistical significance of the relationship.

The test results strongly suggesting that firms employ certain devices over which they have discretion to normalise reported earnings.

Healy (1985) conducted a more holistic research using total accruals (scaled by lagged total assets) as proxy for discretionary accruals (DA) and hence earnings management for the first time as against specific component accruals used by prior researchers as proxy for earnings management.

$$TA_t = DA_t \qquad (6)$$

This study, which is a classic, has also generated reactions and subsequent researches that have led to a new paradigm in earnings management detection modelling in accounting research.

Authors cite that he was criticized by Kaplan (1985) for his stand on discretionary accrual and receivables effect on earnings instead of cash flow, his inability to present an expectation model for normal accruals and to clearly separate total accrual into non-discretionary and discretionary implicitly assumed that in the absence of earnings maximization behaviour of managers total accruals will be zero.

Kaplan also noted that changes in several working capital accounts and thereby accruals depend upon the economic circumstances of the firm which should ordinary affect non-discretionary accruals.

After mentioning some improvements by De Angelo, in 1986, and McNichols & Wilson, in 1988, Apedzan *et al.* (2014) referred to the Jones Model explaining Jones, in 1991, investigated earnings management during import relief investigations by US government using two stage models.

The researcher used firm-specific expectation model and a minimum of fourteen year time series data as estimation period.

The research measured 'normal' total accruals (Non-discretionary Accruals) in estimation period from financial statement data and used it to compute firm specific parameters (coefficients) and the same model during event period (prediction period) to measure expected Non-Discretionary Accruals (NDA_t) using coefficients obtained in the estimation period. The Discretionary Accrual (DA_t) which is the residue or prediction error is calculated by subtracting expected Non-Discretionary Accruals (NDA_t) from current or actual total accruals (TA_t) computed from financial statement data.

Estimation Period Model:

$$NDA_t/ T_{t-1} = \alpha oi\ (1/T_{t-1}) + \alpha_{1i}\ (\Delta REV_t/ T_{t-1}) + \alpha_{2i}(PPE_t/ T_{t-1}1) \qquad (7)$$

Where Tτ-1 = Lagged total assets in estimation period (τ-1), ΔREVτ = Revenues in years τ less revenue in year τ-1 scaled by total assets in year τ-1, PPE = gross Property Plant and Equipment in year τ scaled by total assets in year τ-1, α0i, α1i and α2i are firm specific parameters or coefficients τ = 1, 2, 3, …..T years index for estimation period and i = 1, 2, 3 ….N firm index.

Event Period Model:

$$NDA_t/ T_{t-1} = \beta_{0i}\ (1/T_{t-1}) + \beta_{1i}\ (\Delta REV_t/ T_{t-1}) + \beta_{2i}(PPE_t/ T_{t-1}1) + \varepsilon t \qquad (8)$$

Where NDAt = expected non-discretionary accruals in event year, T_{t-1} = Lagged total assets in event year (t_{-1}), ΔREV_t = Revenues in years t less revenue in year t-1 scaled by total assets in year t-1, PPE = gross Property Plant and Equipment in year t scaled by total assets in year t-1, β_{0i}, β_{1i} and β_{2i} are firm specific parameters or coefficients from α_{0i}, α_{1i} and α_{2i} computed during estimation period t = 1, 2, 3, …..T years index for event period and i = 1, 2, 3…..N firm index.

$$DA_t = TA_t – NDA_t \qquad (9)$$

or

$$\varepsilon_t = DA_t = \{TA_t / T_{t-1}\} - \{(\alpha_{oi}(1/T_{t-1}) + \alpha_{1i}(\Delta REV_t / T_{t-1}) + \alpha_{2i}(PPE_t / T_{t-1})\} \quad (10)$$

Where TA_t = Actual total accruals from financial statement data = {Δ Current assets – Δ cash – Δ current liabilities – Δ Current maturities of long term debt – Δ Income taxes payable - Depreciation and amortisation expenses}.

Accruals (DA) derived from firm-specific expectations model is used to measure earnings management rather than discretionary component of a single accrual account used by McNichols and Wilson in 1988. According to Apezdan *et al*. (2014), total accruals should capture a larger portion of managers' manipulations than single accrual account.

The expectation model according to the researcher should also control for economic conditions on the level of accruals. In this case change in revenues is used to control for economic environment of the firm because they are an objective measure of the firms operations before managers' manipulations.

The model also included gross Property, Plant and Equipment as control for the portion of total accruals related to nondiscretionary depreciation expenses in the event period. The research concluded that managers decreased earnings through earnings management during import relief investigations.

Apedzan *et al*. (2014) mention Dechow *et al*. (1995), took the profession unaware when the third female led a group of researchers in the accrual modelling algebra to propose a modification to Jones' model.

According to them the modification is to eliminate an error in the measurement of discretionary accruals from the standard Jones model. The Jones model implicitly assumed that discretion is not exercised over revenue in either the estimation or the event period.

The reasoning of the modified model is that all changes in credit sales in the event period result from earnings management. The researchers corrected the error by incorporating the changes in credit sales (ΔREC) to the standard Jones model in the event period.

Event model:

$NDA_t = \beta_{01}(1/T_{t-1}) + \beta_{1i}(\Delta REV_t - \Delta REC_t) + \beta_{2i}(PPE_t) + \varepsilon t$ Event period (11)

NDA_t , ΔREV_t , ΔREC_t , PPE_t All Scaled by lagged total assets in event period (T_{t-1}) and β_{0i}, β_{1i} and β_{2i} are from α_{0i}, α_{1i}, α_{2i} respectively computed during estimation period.

$DA_t = TA_t – NDA_t$ (12)

or

$\varepsilon_t = DA_t = \{TA_t\} - \{(\alpha_{oi}(1/T_{t-1}) + \alpha_{1i}(\Delta REV_t - \Delta REC_t) + \alpha_{2i}(PPE_t)\}$

(13)

Where DA= Discretionary accruals in year t

TA_t = Actual total accruals from financial statement data = {Δ Current assets – Δ cash – Δ current liabilities – Δ Current maturities of long term debt – Δ Income taxes payable - Depreciation and amortisation expenses}.

Estimation model remains the same.

$NDA_t = \alpha_{0i}(1/T_{t-1}) + \alpha_{1i}(\Delta REV_t) + \alpha_{2i}(PPE_t)$ Estimation period (14)

NDA_t , ΔREV_t , PPE_t All Scaled by lagged total assets in event period (T_{t-1})

The research also evaluated alternative accrual based models for detecting earnings management and concluded that in terms of specification all the models appear well specified but the modified Jones model exhibits the most power in detecting earnings management.

Some other models to detect earnings management through total discretionary accruals by mathematical modelling using cross sectional data; manipulation scores by use of mathematical model using financial and proxy statements; cross sectional distribution of earnings and accrual models; real activities manipulation and through artificial neural networks (ANN) modeling were commented by these authors, but since the present research uses the modified Jones model those last ones are not described here.

Their review concludes that robust models have been discovered in detecting earnings management, but some of these models are on the shelves of academics without practical research commercialisation and utilisation by industries.

A review on last ten years literature linking earnings quality to Hofstede's cultural dimensions points out the following interesting studies:

Initially, Guan *et al*. (2005) aimed to detect the effect of cultural environment on earnings manipulation for five Asia-Pacific countries; comparing cultural dimensions vs. earnings manipulation –measured as discretionary accruals, obtained from a cross-sectional version of the modified Jones model– and identified positive significant relation between individualism and discretionary accruals and a negative significant relation between uncertainty avoidance and discretionary accruals.

In their analysis for Singapore, Malaysia, Hong Kong and Japan, from 1987 to 1995, they used discretionary accruals –obtained from a cross-sectional version of the modified Jones model– as a proxy and controlled for firm-specific characteristics such as the debt to equity ratio and the size of the firm, measured as the natural logarithm of total assets, and they find as well a negative significant relation between discretionary accruals and long-term orientation.

Nabar & Boonlert-U-Thai (2007) analysed cultural differences and investor protection vs. earnings management –measured as average score of earnings discretion and earnings smoothing– and their results show significant positive effect of uncertainty avoidance on earnings management, remains for earnings discretion after splitting earnings management in the two components; disappears for earnings smoothing, and detected a significant negative effect of outside investor rights on earnings management.

They analyse 30 countries –same sample as Leuz *et al*. (2003)– from 1990 to 1999 and use an average score of earnings discretion and earnings smoothing as measure for earnings management and controlled for "outside investor rights" and "legal enforcement" as well as for religion and language. Most significant effect can be explained by a dummy-variable that controls for the country's primary language being English.

Doupnik (2008) compared cultural dimensions vs. earnings management, measured as country's average rank of earnings smoothing and earnings discretion, and discovered significant positive effect of uncertainty avoidance on earnings management; a significant negative effect of individualism on earnings management and a significant negative effect of outside investor rights on earnings management.

Author used data by Leuz *et al*. (2003) for the 31 countries and a ten years period and controlled for the institutional differences, such as outside investor rights –obtained from the anti-director rights index by La Porta et al. (1999)– and legal enforcement –again an average of the efficiency of the judicial system, the degree of corruption, and the degree of legal enforcement– and a distinction between code-law and common-law countries, such as suggested by the 2000 work by Ball *et al*.

It is worthy to mention that after dividing earnings management in the original variables, earnings smoothness and earnings discretion, Doupnik (2008) finds the results are similar for earnings discretion as for the aggregate value of earnings management. The significant effects of uncertainty avoidance and outside investor rights on earnings smoothness, however, disappear.

Han *et al*. (2010) developed a cross-country study, with a sample of 32 countries and from 1992 to 2003, to link earnings discretion –measured as absolute value of discretionary total accruals– vs. cultural dimensions and noticed significant positive effect for individualism and masculinity on earnings discretion.

They also found a significant negative effect of uncertainty avoidance on earnings discretion and a significant effect of interaction between individualism and investor protection and between uncertainty avoidance and investor protection on earnings discretion.

The authors measured investor protection as a mean score of legal variables such as the efficiency of the judicial system and the degree of corruption within each country and detected cultural dimensions significance beyond other significant issues of firm's specific characteristics, like firm-size or book-to-market ratio.

Guan & Pourjalali (2010), prepared a document using only the first four Hofstede's cultural dimensions (PDI, IDV, MAS & UAI), because LTO scores were only available for fourteen of the 27 countries in their sample and IVR has not been developed.

Their findings were similar to those of the Guan *et al*, work (2005) but this time they associated cultural values and earnings management, for the above mentioned twenty seven countries and in the period 1987–2001, measuring earnings management with discretionary accruals calculated according to the modified Jones (1991) model.

They controlled for the size of the firm –total assets–, its debt to equity ratio and two scores from the Leuz *et al*. (2003) study: the disclosure score index and the earnings management score.

These authors performed regressions for the direction of earnings management, upward or downward, and for the magnitude of earnings management –absolute value of earnings management– where they realised that, at the direction of earnings management, PDI, IDV and MAS all have negative significant effect on this direction.

Additionally, size of the firm has a negative effect on the direction of earnings management, meaning larger firms are more likely to assess downward earnings management. The association between debt to equity ratio and the direction of earnings management is positive, which means that the higher the debt to equity ratio, the more upward earnings management.

Magnitude of earnings management, for all four cultural dimensions, have a significant effect while UAI has a negative significant effect on the absolute magnitude of earnings management, whereas PDI, IDV and MAS all have positive significant effects on the absolute magnitude of earnings management.

The debt to equity ratio (negative) and the size of the firm (positive) also have significant effects on the absolute magnitude of earnings management, which means large firms manage earnings more (but downwards, as seen before) and firms with higher debt to equity ratios manage earnings less (but upwards).

Kanagaretnam *et al*. (2011) focused on banks and analysed cultural differences vs. small changes in ROA and income smoothing through loan loss provisions, where they identified a strong and significant negative relation between uncertainty avoidance and small changes in ROA; a strongly positive significant relation between small changes in ROA and individualism, power distance, and masculinity respectively and a significant negative –positive– relation between power distance, masculinity, uncertainty avoidance and income smoothing through loan loss provisions.

They worked with a sample of banks in 39 countries, from 1993 to 2006, and decided to regress small changes in earnings –scaled for total assets, hence they used the change in ROA as proxy for earnings management– to Hofstede's cultural dimensions and country-specific and firm-specific control variables, while they used, as another proxy for earnings management, income smoothing through loan loss provisions, which is a common way for banks to smooth income according to prior literature.

Salter *et al*. (2013) preferred to research on social and accounting values vs. conservatism and they concluded there is a negative relation between masculinity and both conditional and unconditional conservatism.

They reviewed 22 countries, from 1989 to 2006, and found significant evidence that accounting conservatism –both conditional and unconditional– is related to the accounting values as identified by Gray (1988) and that for conditional conservatism, only the positive effect of femininity remains.

This means that accounting conservatism, or risk avoidance, is more likely in countries with a lower degree of masculinity, which can be seen as more feminine.

Riahi & Omri (2013) examined the possible impact of value systems –using PDI, IDV, MAS, UAI and LTO– on earnings management for a sample of 219 listed companies in France, Tunisia and Canada, from 2003 to 2009.

As there are no Hofstede's scores for Tunisia, authors used "The stabilising of Culture Patterns" (see figure 1.3 in the present study) and some other authors reasoning to develop "equivalents" for such scores.

Their contribution includes a developing country whose culture may have different sources because it is influenced by several cultures: French, African and Arab-Muslim ones. Moreover, Tunisia has several features similar to France such as financing ways, governance system and priorities in accounting practices.

However, this nation has undergone a political transition –from a centrally planned to a market economy– and joined the GATT agreement additionally to adopting an accounting system with a conceptual framework and the launch of the first guide to good governance practices of companies, a guide for annual reports of Tunisian companies, etc. Such a study preferred the method of structural equation models (SEM), over regression, firstly because authors explained cultural dimensions are unobservable and secondly they were testing the relationship between variables that are approximations of constructs.

Authors reported ecological factors were able to determine cultural dimensions in the sample countries and that only three cultural dimensions are significant in explaining differences in earnings management, with a positive relation to UAI and a negative one to PDI and IDV.

Shah (2014) shares a different point of view for LTO and financial performance referring to myopic management –one which makes decisions based on short-term profitability as opposed to the long-term value– typically cutting discretionary expenditures like advertising and R&D which result in the destruction of the long-term value of the firm.

After collecting data from 1995 to 2012 in Japan, South Korea, Germany and the United States, author discovered managers typically expect long-term benefits from discretionary expenditures, however, because of the uncertainty tied to the long-term benefits of these expenditures it creates disincentives to spend on those, while pressures of the financial markets to meet projected earnings may force managers to engage in this behaviour, and sometimes it may also be due to the personal interests where their compensation may be tied to meeting these projected short-term earnings.

Findings support the hypotheses that firms from long-term oriented cultures spend more on R&D and advertising than firms from short-term cultures which then translates to higher profitability for firms from long-term oriented cultures in comparison to firms from short-term oriented cultures.

CHAPTER 2

Research design

2.1 OBJECTIVE AND HYPOTHESES DEVELOPMENT.

The objective of this thesis is to assess the impact of culture and legal systems on earnings management because, as academic research has evidenced, public companies are still misrepresenting their economic performance in relevant percentages even though IFRS have helped to diminish reporting discretion in a considerable way.

Culture is a highly complex construct and countries follow different patterns to better use legal and accounting features where earnings management decisions are to be made.

So, recently, analysing the impact of culture as an explanatory variable is an issue that can be found in various social, scientific, and economic arenas.

First four Hofstede's cultural dimensions have been frequently used to assess the relationship with accounting aspects and, somehow, with earnings management but using his last two dimensions –Pragmatic vs. normative & indulgence vs. restraint– is still not so common, while a relatively unexplored field resides in linking his six dimensions to legal systems influencing in earnings management.

By identifying and measuring the way cultural dimensions impact on earnings management in different countries it might be easier to understand motivations supporting management behaviour and related decisions in order to help accounting standards setters, regulators and users of financial information to get access to internationally comparable and high quality financial statements.

Therefore, in this thesis an international sample to check this three-fold relationship, comparing discretionary accruals –direction and magnitude– through a ten years period, is used aiming to identify country-specific characteristics.

This work also aims to extend works which used only the first four Hofstede's cultural dimensions so data are collected incorporating updated and additional data from different sources.

An important contribution and differential aspect of this thesis is the analysis of the moderating role of the legal systems in the relationship between accruals and culture.

Consequently, two questions are formalised:

A. May cultural attributes impact on the way a country manages earnings? and
B. Would Hofstede's six cultural dimensions explain why earnings management issues might not be equally applied in different countries?

To answer those questions, the following six hypotheses –first two of them similar to those included in the Guan & Pourjalali (2010) research– will be tested, only now the related financial figures period corresponds to 2002-2013, Hofstede's fifth and sixth cultural dimensions are included and differences between Anglo-Saxon and Continental accounting systems models are assessed. Then, the hypotheses tested are the following:

H1: There will be a decrease in accounting accruals in countries where UAI is high.

UAI scores run from 8 (for Singapore) to 112 (for Greece) in Hofstede's sample –see Table 3– so any figure above 60 shall be considered "high" and should correspond to less accruals in order to comply with existing accounting rules.

Literature shows there is an association between low-scored UAI countries and a more adventurous risk-taking attitude which might be accomplished through attempts by managers to control future reported earnings.

Simultaneously, strong uncertainty avoidance leads to a preference for conservative measurement and secrecy is positively related, as less information preserves security and avoids conflict competition.

Some researchers (Sandeep & Boonlert-U-Thai, 2007) have reported earnings management is relatively high in countries with high UAI scores, but their supplementary analysis of earnings management components indicated that UAI was associated with earnings discretion but not with earnings smoothing.

But it is easier to understand that following Doupnik (2008), who stated income-increasing earnings discretion can occur as a result of the desire to avoid the negative impact of certain events, leading to greater usage of earnings discretion, to avoid the uncertainty associated with these potentially negative events.

Guan & Pourjalali (2010) expected managers in high UAI societies will choose income-decreasing accounting accruals to report earnings downward and avoid future risks. Furthermore, they can create a safety zone for future reports, in case they need to adjust earnings upward during the years when actual earnings are lower than expected.

So considering UAI deals not only with risk avoidance but with how the members of a society tolerate ambiguity –meaning if they feel comfortable or uncomfortable with unstructured situations– this first hypothesis is similar to the one authors mentioned in the previous paragraph developed as their first one.

H2: There will be more earnings management –with no direction predicted– in countries with high scores in PDI, IDV & MAS.

As mentioned in the reviewed literature, several authors discovered significant positive effect of UAI on manipulation but nothing clear enough for the other three cultural dimensions as to venture a direction estimate.

Guan *et al*. (2010), accordingly, considered the effect of other cultural values on the direction of earnings management is not as clear as that of UAI. Therefore, being unable to predict the direction of the earnings management for these three cultural values, they tested their second hypothesis.

PDI is positively related with secrecy, because less information is expected to preserve power inequalities, but then an issue –directly related to CEOs, those who decide about different ways to deal with earnings management based on their hierarchy– has been reported (Godfrey *et al.*, 2003) showing a trend to downward earnings management in the year of senior management changes.

They also reported and upward earnings management in the following years, with even stronger results where change was prompted by a resignation rather than a retirement.

A retiring CEO, as documented by Reitenga & Tearny (2003), may attempt to increase reported earnings in his final year –to receive larger bonus payment, to later live in style and to secure lucrative post-retirement board seats– but independent directors and CEO stockholding appear to mitigate the earnings management, while the institutional stockholders appear to exacerbate earnings management in the CEO's final years.

Because high power distance implies that decision structures in organisations are centralised and that authority is concentrated in the hands of the top managers, organisations operating in that kind of countries show lack of both leader communication and participative leadership, with a high incidence of earnings management when top managers are powerful, the CEO also either serves as chairman of the board or is the firm's founder.

IDV demands those who decide about earnings management to focus on what is good for the individual and how would it affect the group, depending on the related scores in this dimension, so a negative relation with secrecy is present and shareholder's goals and managers' objectives might be in conflict, so where senior management is to be compensated by equity incentives, an increased opportunistic behaviour may arise.

Concern for other stakeholders' welfare is indicative of collectivism and participative leadership but researchers have found that managers misstate earnings to maximize their own wealth and earnings management; that IDV is positively associated with the use of pay-for-performance contracts. Personal gain is likely to be an important motivator in high individualism societies and a significant negative effect of individualism on earnings management (Doupnik, 2008) and significant positive effect for individualism on earnings discretion (Han *et al*., 2010) have been reported.

Feminine societies –with low MAS scores– are more opened so there is more disclosure, mainly of socially related information and as a natural extension of their actions focused on the care for other people and the quality of life, but countries with high scores are based on competition, a preference for achievement, assertiveness, and material success.

Accordingly, high MAS societies place emphasis on performance, and managers hold ambitious career aspirations and prefer to work for prominent companies and earn high salaries while they are likely to endeavour to report strong profits that beat benchmarks.

However, female directors can often better improve the earnings quality of firms (Srinidhi *et al*. 2011), as they tend to have better communication skills, hold more informed discussions, and feature better independent thinking, thereby contributing to better monitoring of the managers.

Last paragraphs reinforce the complication related to predicting any direction for PDI, IDV and MAS but confirm the fact that high scores on those three dimensions might derive in more earnings management.

H3: There will be a higher magnitude of earnings management in countries with low Disclosure Index and Earnings Management scores.

Companies in countries with developed equity markets, dispersed ownership structures, strong investor rights and legal enforcement engage in less earnings management.

Above mentioned characteristics are related to three main issues: 1) sufficient disclosure, meaning figures easing their correct interpretation by the investor; 2) reasonable disclosure, connected to giving equal treatment to all users of financial statements by providing adequate information and 3) full disclosure, regarding the completeness of the relevant information disclosed, considering too much information would jeopardize and difficult interpretation of financial statements.

Managers may try to hide bad news by writing text that is more difficult to decipher but, also, bad news is inherently more difficult to communicate.

Because of the nature of accounting conservatism –recognizing bad news in a more timely fashion than good news–managers are required to provide more explanation about the future when there are losses.

Nazh (2011) found significant correlation between the cultural dimensions and the disclosure index, except for masculinity; a significant negative correlation between financial disclosure and uncertainty avoidance and power distance as well as significant positive correlation between disclosure and individualism.

Then he prepared another regression, including only one cultural dimension at a time, and discovered a significant positive correlation between disclosure index and total assets, suggesting that large companies disclose more information in their financial statements.

Furthermore, he stated the significant positive correlation between disclosure index and legal enforcement and market capitalisation indicates that financial disclosure is higher in developed markets.

And if, as mentioned by Hofstede, there is a relation between MAS and wealth, the significant correlation with net profit margin and disclosure index also points out that, profitable companies disclose more information.

Guan *et al*. decided to use two scores compiled by Leuz *et al*. (2003) –EMS & DS– explaining the first served as a dependent variable and Hofestede's cultural values as independent variables. The cultural values explain over 40 per cent of the variations in EMS scores, suggesting that cultural values are represented in the EMS scores, and included them in their model to test their sixth hypothesis, and in the present research a similar approach is used.

In addition to the previously referred three hypotheses and considering the present study now includes the last two cultural dimensions reported by Hofstede –PRA was only reported for a few countries when Guan & Pourjalali finished their research and IVR was not ready until 2010– another three new hypotheses will be tested as well.

H4: There will be more earnings management where PRA scores are low.

The lower the degree of Pragmatism –or Long term Orientation– in a society the more interest in earnings management for companies, so this cultural dimension will show better forecasting attributes than the Uncertainty Avoidance Index.

The Hofstede's fifth cultural dimension effect on earnings management is under-researched but, as previously stated in the present thesis; societies who score high in this dimension are oriented towards future rewards, associated with persistence, observing order, sense of shame and the existence of many truths based on time and context.

They show as well a strong propensity to save and invest and perseverance in achieving results, a priority to steady growth of market share rather than a quarterly profit, because companies should serve stake holders and society at large for many generations to come.

Those nations who score low emphasise quick results and the bottom line, they value personal steadiness and stability and a strong concern with establishing the absolute truth and a relatively small propensity to save for the future. Therefore, managers might be tempted easily to adjust income figures in order to keep their jobs for a longer time.

Evoking literature mentioned in this study, loss of personal reputation is another important factor behind earnings management for this cultural dimension, because neither fraud, or fraudulent intent, nor inadequate accounting rules are necessary requirements for producing unreliable financial reports.

Bar-Gill and Bebchuk (2002), while developing a model of causes and consequences of (both legal and illegal) misreporting corporate performance, show "[…] that even managers who cannot sell their shares in the short-term might misreport in order to improve the terms under which their company would be able to raise capital for new projects or acquisitions.

Gill (2003) recalls that, undoubtedly, the accounting scandals that occasionally come to light, and even more those related to the sub-prime crisis in the US, notably determine public opinion to the opportunistic –meaning short-term oriented– vision of accounting discretion.

As previously commented, Callao & Jarne (2010) results obtained show that earnings management has intensified since the adoption of IFRS in Europe, as discretionary accruals have increased in the period following implementation.

So the authors reasoned that such a fact may be connected to the differences between IFRS and local standards with regard to the valuation criteria of property, plant and equipment, an item that concerns long-term discretionary accruals.

H5: IVR will affect earnings management.

Even where people in nations with a high score will tend to have a relative weak control over their impulses, in the low ranges of this dimension they will regulate their need for gratification by means of strict social norms and such a conduct, associated to the "search for happiness", may result in managers being more likely to leave the company when they consider their duties –like following accounting rules– feel inappropriate for them. However, there is no prediction about the direction of the earnings management for IVR.

Dominant school of thought in contemporary economics consider rational wo/men are self-interested hedonists and utility maximisers, so it seems they respond to a stimuli, like accounting numbers, then make informed decisions to achieve desired results, reinforce the degrees of hedonism that they receive and rationalise their future behaviour based on this reinforcement.

According to that point of view, man exists for his own sake, and the achievement of his own happiness is his highest moral purpose, so decision-makers have increasingly behaved in ways that are self-interest fulfilling, deriving in numerous high-profile white-collar crimes and corporate frauds reported especially in the last two decades.

However, rationality is a matter of choice –motivation, objectives and substantive principles– so it is to be logical and to use reasons while acting as a conscious decision-maker, using the ability to calculate consequences of his decisions.

Then a rational choice entails two kinds of calculative guesses: future consequences of current actions and future preferences for those consequences, which turn complicated ones because of the presence of future uncertainties.

It is then crucial to understand earnings management can stray into manipulation when directional goals –like receiving more remuneration or meeting earnings numbers– overshadow accuracy goals related to manage earnings prudently (Siddharth, 2011).

Therefore in the present research it is considered IVR shall definitely affect earnings management.

Considering the PRA and IVR cultural dimensions are now part of the hypotheses in the present thesis, expectations for the impact of the six dimensions on the magnitude and direction of earnings management are shown in the following table:

Effect on	PDI	IDV	MAS	UAI	PRA	IVR
Magnitude of EM	+	+	+	?	--	?
Direction of EM	?	?	?	--	--	?

Notes:

(–) Represents negative relationship

(+) Represents positive relationship

Table 2.1 Magnitude and Direction signs for this thesis

Apart from the above hypotheses, we consider that the effect of Hofstede's dimensions on earnings management will be conditioned by the legal tradition.

Then, we pose the following hypothesis:

H6: The legal model (Continental versus Anglo-Saxon) moderates the association between Hofstede's dimensions and discretionary accruals.

Another important issue reported in literature relates to legal tradition and the way it affects accounting issues.

Borker (2012) mentions that in his original article, Gray notes that the accounting value of Optimism (opposite of Conservatism), Flexibility (opposite of

Uniformity), Professionalism and Transparency (opposite of Secrecy) are characteristic of the Anglo-Saxon Accounting / Legal tradition, where societies show strong democratic values with a long-standing tradition of publically-traded stock companies and an emphasis on financial reporting that meets the needs of individual equity investors.

Analysing the legal / regulatory system and its link to external corporate governance, 2010 research by Denis shows that "common law countries provide the strongest degree of protection for shareholders", because normally, firms in common law countries, where investor protection is stronger, make higher dividend pay-outs (Choy *et al*., 2011).

Another analysis about differences between Spain, UK and the US was prepared by García-Teruel *et al*., (2010) as they cited some other authors and stated Spain is classified as a code law country characterised by weak investor protection, a less developed capital market, a high concentration of ownership and higher levels of earnings management than Anglo-American countries.

There are reports as well as on how females are becoming increasingly represented on Boards.

Legal systems that effectively protect outside investors reduce insiders' need to conceal their activities, while earnings management is more pervasive in countries where the legal protection of outside investors is weak.

That is because in these countries insiders enjoy greater private control benefits and hence have stronger incentives to obfuscate firm performance.

Callao & Jarne (2010) referred these results suggest that IFRS have actually encouraged discretionary accounting and opportunistic behaviour, with a consequent impact on the quality of financial information and, because the countries where earnings management has increased the most, with a significant increase for the current, long-term and total discretionary accruals are France and the UK, countries traditionally regarded as representative of the Continental European accounting model, in the case of France, and Anglo-Saxon model in the case of the UK, that allowed the authors to think that the source accounting model is not decisive for the impact of the IFRS on earnings management.

So the newest two cultural dimensions have not been sufficiently researched yet, but the most relevant characteristics of the main accounting models may be easily linked to specific cultural traits like influences which existed on specific countries since long ago and derived in a degree of prudence in accounting measurement reflected in the principle of conservatism against true and fair view, limitations on income distribution vs. dominance of the accrual principle or tendencies to higher / lower hidden reserves, which are influenced by a short / long term orientation, so the legal systems influence on discretionary accruals shall be tested with this final hypothesis.

Three control variables are then used in this thesis: Debt/Equity, Size and the firm's effective income tax rate.

The first traditional factor relates to debt / equity ratios in the firms included in the sample because a healthy firm will find it easier to contract debt, than those financially distressed, so the closer those firms with large debts are to violating debt covenants restrictions, the more likely their managers will make income-increasing accounting choices, the so called "positive earnings management" line.

Authors, like Guan & Pourjalali (2010), pointed out Japanese corporations borrow money from banks, while most large U.S. corporations borrow through the issuance of long-term bonds.

Furthermore, on average, Japanese companies have a higher debt-to-equity ratio than do U.S. companies, and the higher rate does not necessarily mean that the firm is closer to debt covenant violations.

In the present research sample, Sweden and Canada are more oriented to borrow money like Japan; Germany and Portugal do so through banks while France, the U.K. and Spain use both but so, after the global financial debt crisis, awareness about how much financial conditions have an important role on the level of the firms' earnings management policies became crucial.

When leverage financial figures tend to deteriorate, that may motivate firms to manipulate earnings outcomes, exercising the discretion provided in the accounting numbers, to avoid the unfavourable corresponding effects.

Managers exercising discretion by choosing income increasing accounting methods, relax debt constraints and reduce the costs of technical default and that may help them to either issue equity or obtain new debt at lower costs and easier to then augment the firms' activities, expand investments and keep on growing.

Therefore, following Healy and Wahlen (1999), who demonstrated earnings management practices could be observed in times of capital raise, and considering the effect is the same where debt is searched, this control variable will be used.

The second control variable focuses on the size of the firm, considering big size firms will use strategic accruals management, in this case the so called "big bath", enabling them to achieve better performance in the future as well as achieving a quick turnaround in their subsequent operating performance after a significant dividend reduction or omission, for example.

According to different authors, size appears to be a primary earnings management issue because larger firms try to avoid political exposure as well as increased monitoring and are therefore more familiar with income decreasing accounting choices.

Reputation and credibility for big size firms might originate higher costs from engaging in earnings management activities, as well as litigation risks and, additionally, their financial statements are usually audited by big auditing companies hence those firms might more likely avoid manipulation due to increased scrutiny form financial analysts and investors as well.

Large firms usually have more resources, sophisticated internal control systems and earn higher profit so it is expected that kind of companies would only use income-decreasing discretionary accruals.

The opposite happens for small firms, which find it complicated to hire talent and, in the wake of the Sabarnes-Oxley Act and the ensuing reforms by the stock exchanges, it is even harder for them to hire personnel fulfilling such requirements and who is willing to bear additional risks imposed on directors.

Consequently, managers in small firms might manage earnings more frequently to reach the threshold more often than managers at big firms, but the country where the firm operates is also important and big companies might be questioned and rejected, if authorities focus on monopoly facts, or such authorities consider market dominance, domestic and abroad, is something to be pursued because they are not attracted by anti-trust feelings.

For this control variable, Guan *et al*. (2005) assessed the size factor and considered possible that the accounting accrual behaviour of larger and smaller firms may differ because of factors other than political sensitivity depending on the country –economic climate is friendlier to large businesses in Japan and Hong Kong, compared to that one in the U.S.– so they thought this issue, related to the so called “negative earnings management”, might not hold for individual countries.

Notwithstanding, they expected it would hold for their sample, which comprised multiple country-years, so for the present study this control variable measures size by total assets.

Third control variable takes tax rates into consideration, as it is recognised companies face inherently conflicting interests in their reporting for financial and tax purposes because a higher taxable income can result in additional tax liabilities.

However, tax policy and tax administration in some countries are much different from others and so are the level as well as the structure of taxation and firms’ tax saving practices as was evidenced, for example, in the 2008 corporate tax reform in China.

New law abolished tax incentives, applicable only to foreign companies, and introduced consistent tax treatments on all forms of enterprise, low tax rates to small and low-profit firms as well as high-tech entities and accelerated deductions on expenses related to R&D and green activities.

Reports show the unified 25 percent corporate tax rate –the largest income tax rate reduction since China imposed a 33 per cent tax rate on domestic firms in 1994– originated domestic firms in the real state sector managed earnings, including accrual earnings management and real earnings management, to decrease income in the fourth quarter of 2007, and to increase income in the first quarter of 2008.

Another study, investigating whether the Tax Reform Act of 1986 in the United States –which reduced the maximum corporate tax rate from 46 percent to 34 percent– would attract large firms to reduce financial statement income to achieve tax savings in the year prior to the effective date of the Reform, reported significantly lower current accruals for that kind of firms.

Profit taxes for the sample in the present thesis, as a percentage of profit, are 0.5 for France; 3.9 for Canada; 8.4 for Belgium; 12.7 for Taiwan; 13.1 for Sweden; 13.3 for Spain; 13.6 for Portugal; 17.5 for Hong Kong; 18.2 for Korea; 19.2 for the U.K.; 19.5 for Thailand; 20.3 for Philippines; 20.4 for Netherlands; 23.2 for Germany; 24.9 for India and 28.9 for Japan, so differences form high to low tax rates shall be considered here.

Previously mentioned tax rates derive from the World Bank Group, through their Doing Business Web page, where they report mandatory contributions that a medium-size company must pay or withhold in a given year and correspond to the most recent round of data collection completed on June 1, 2015 covering for the Paying Taxes indicator calendar year 2014 (January 1, 2014 - December 31, 2014), while methodology may be consulted at: http://www.doingbusiness.org/ data/exploretopics/paying-taxes.

Guan and Poujalali (2010) expressed it is obvious that if earnings management can affect the amount of income taxes, managers in higher tax rate environments have more incentives to manage earnings downward (negative earnings management), so they used the average effective tax rate based on the company's ratio of total tax payment to total taxable income to test the present hypothesis and related figures reported by Bloomberg are used in the present thesis.

2.2 SAMPLE SELECTION.

Four criteria were used to integrate the sample:

- Cultural variables.

Culture has received less attention in recent literature –than broad systemic, legal or institutional issues– to explain earnings management motivations, while more relevant issues of cross-country differences can be operationalised using the Hofstede's six cultural dimensions (H6D) model.

Therefore, the H6D model is the one used in this thesis, as it has been theoretically and empirically proved these dimensions explain cross-national differences in accounting practices.

The starting point was to include only those countries reporting scores for the six Hofstede's cultural dimensions: Power Distance Index (PDI), Individualism vs. collectivism (IDV), Masculinity vs. Femininity (MAS), Uncertainty Avoidance Index (UAI), Pragmatism (PRA), previously called Long-short Term Orientation, and Indulgence vs. Restraint (IVR), and deleting those countries who missed any of those scores:

#	COUNTRY	#	COUNTRY	#	COUNTRY	#	COUNTRY	#	COUNTRY
1	Africa East	14	Colombia	27	India	40	Morocco	53	Slovak Republic
2	Africa West	15	Croatia	28	Indonesia	41	Netherlands	54	Slovenia
3	Arab countries	16	Czech Republic	29	Iran	42	New Zealand	55	Spain
4	Argentina	17	Denmark	30	Ireland	43	Norway	56	Sweden
5	Australia	18	El Salvador	31	Italy	44	Pakistan	57	Switzerland
6	Austria	19	Estonia	32	Japan	45	Peru	58	Taiwan
7	Bangladesh	20	Finland	33	Korea South	46	Philippines	59	Thailand
8	Belgium	21	France	34	Latvia	47	Poland	60	Trinidad and Tobago
9	Brazil	22	Germany	35	Lithuania	48	Portugal	61	Turkey
10	Bulgaria	23	Great Britain	36	Luxembourg	49	Romania	62	U.S.A.
11	Canada	24	Greece	37	Malaysia	50	Russia	63	Uruguay
12	Chile	25	Hong Kong	38	Malta	51	Serbia	64	Venezuela
13	China	26	Hungary	39	Mexico	52	Singapore	65	Vietnam

Table 2.1 Countries (65) with scores for each dimension in Hofstede's 6D Model

After deleting 45 entities –those showing only some of the six required scores from the initial 110 reported by Hofstede– those 65 countries in Table 2.1 remained in the sample.

- Earnings Management and Disclosure measures.

Empirically obtained scores for earnings management and disclosure (EMS & DS), available in Leuz *et al*. (2003), where then considered to discriminate through countries.

Considering these two constraints limited sample to those twenty eight countries shown in Table 2.2, as there are no DS scores for Indonesia, Ireland and Pakistan.

#	COUNTRY	#	COUNTRY	#	COUNTRY	#	COUNTRY
1	Africa West	8	France	15	Japan	22	Singapore
2	Australia	9	Germany	16	Korea South	23	Spain
3	Austria	10	Great Britain	17	Malaysia	24	Sweden
4	Belgium	11	Greece	18	Netherlands	25	Switzerland
5	Canada	12	Hong Kong	19	Norway	26	Taiwan
6	Denmark	13	India	20	Philippines	27	Thailand
7	Finland	14	Italy	21	Portugal	28	U.S.A.

Table 2.2 Countries (28) discriminated through EMS & DS

- Diversity, among PRA & IVR scores.

PRA scores are the same for Italy and Hong Kong (61), Denmark and Norway (35), India and U.K. (51), while IVR scores are identical for Austria and South Africa (63), Belgium and Finland (57), Canada and the U.S. (68), Japan and Philippines (42), so in some cases one from each pair was eliminated as diversity was sought to select countries.

Interest on analysing Asian countries prevailed to keep Hong Kong in the sample, contrasted to quite an irregular economic situation in Italy, which might be reflected in the irregular way they report financial data; Norway shows a closer to the average score (55) for IVR and 50 for UAI, meaning this country has no noticeable preference on that last dimension and only a slight difference for IVR, so it was discarded.

Recent economic pre-eminence in India, as part of the BRIC, makes it advisable to keep it and the U.K as well, additionally; they show quite opposite scores for IVR (26 and 69 respectively).

Then South Africa was initially preferred over Austria, which was eliminated, but then it has a peculiarity as it only shows scores for PRA & IVR while the other four dimensions (PDI, IDV, MAS & UAI) are reported only for the “white” part of Africa, so it was discarded as well.

Finland, as part of the Nordic group, might be well represented by Sweden and Denmark so it was eliminated.

Canada was preferred over U.S as culture effects on earnings management has been widely analysed, and Hofstede reports Americans “have very strong ideas about what is “good” and “evil” and measure their performance on a short-term basis, with profit and loss statements being issued on a quarterly basis. This also drives individuals to strive for quick results within the work place”.

Both, Japan and Philippines, remained in the sample with quite opposite scores for PRA (88 and 27 respectively).

#	COUNTRY	#	COUNTRY
1	Australia	12	Korea South
2	Belgium	13	Malaysia
3	Canada	14	Netherlands
4	Denmark	15	Philippines
5	France	16	Portugal
6	Germany	17	Singapore
7	Great Britain	18	Spain
8	Greece	19	Sweden
9	Hong Kong	20	Switzerland
10	India	21	Taiwan
11	Japan	22	Thailand

Table 2.3 Culturally diverse countries in the sample

Then, 22 countries remained in the sample after this cultural issues filter.

- Sufficient and complete financial information.

Listed companies, 10 at least in each country, must have financial information for an eleven years period, from 2002 to 2013, and for each one of the following variables based on the modified Jones (1991), to calculate accruals:

a. Current assets (*CA*).
b. Cash (*CASH*).
c. Current liabilities (*CL*).
d. Current portion of long term debt (*CMLTD*).
e. Depreciation and amortization (*DEP*).
f. Total assets (*A*).

Nondiscretionary accruals calculation demands financial data "a" to "c" to be sufficient and complete as well, while testing the model requires data on "d" and "e":

a. Revenues (*REV*).
b. Receivables (*REC*).
c. Gross property plant and equipment (*PPE*).
d. Debt to equity ratio (*DE*).
e. Effective tax rate (*TR*).

Source for financial information is Bloomberg Professional service, but Greece faced economic troubles in recent years and some of their reports were missing; Switzerland listed companies were almost the same in France, so France prevailed, while some other countries (Australia, Denmark, Malaysia and Singapore) did not comply with all of the aforementioned requisites.

Sample was reduced to the 16 countries reported in Table 2.4, after considering all above mentioned prerequisites.

Nations are identified, in the first column, by the standard codes published by the International Organisation for Standardisation (ISO 3166 Alpha-2).

Number of companies in each country is shown in the third column. Scores for each country's cultural dimensions are shown from 4th to 9th columns and EMS & DS scores are included in the last two columns.

ISO 3166	COUNTRY	COMPANIES	PDI	IDV	MAS	UAI	PRA	IVR	EMS	DS
BE	Belgium	12	65	75	54	94	82	57	19,5	61
CA	Canada	138	39	80	52	48	36	68	5,3	74
DE	Germany	26	35	67	66	65	83	40	21,5	62
ES	Spain	22	57	51	42	86	48	44	18,6	64
FR	France	32	68	71	43	86	63	48	13,5	69
GB	Great Britain	71	35	89	66	35	51	69	7	78
HK	Hong Kong	178	68	25	57	29	61	17	19,5	69
IN	India	26	77	48	56	40	51	26	19,1	57
JP	Japan	180	54	46	95	92	88	42	20,5	65
KR	Korea	71	60	18	39	85	100	29	26,8	62
NL	Netherlands	16	38	80	14	53	67	68	16,5	64
PH	Philippines	23	94	32	64	44	27	42	8,8	65
PT	Portugal	10	63	27	31	104	28	33	25,1	36
SE	Sweden	25	31	71	5	29	53	78	6,8	83
TH	Thailand	35	64	20	34	64	32	45	18,3	64
TW	Taiwan	323	58	17	45	69	93	49	22,5	65

Table 2.4 Complete and final sample

The final sample consists of sixteen countries with a total of 1,188 listed companies and –for this research's purposes– there is an appropriate representation of cultural issues, legal systems and different industries as well, as described below.

The Global Industry Classification Standards (GICS) codes are used in this thesis for the cross-sectional variation analysis to relax the assumption that coefficients of the revenues changes and gross fixed assets are constant for each company over time, then assuming those are constant for companies in the same sector during the same exercise.

CODE	SECTOR	GICS INDUSTRIES
10	Energy	**1010**: Energy. 101010 Energy equipment & services; 101020: Oil, gas & consumable fuels.
15	Materials	**1510**: Materials. 151010: Chemicals; 151020: Construction materials; 151030: Containers & packaging; 151040: Metals & mining; 151050: Paper & forest products.
20	Industrials	**2010**: Capital goods. 201010: Aerospace & defense; 201020: Building products; 201030: Construction & engineering; 201040: Electrical equipment; 201050: Industrial conglomerates; 201060: Machinery; 2010170: Trading companies & distributors. **2020**: Commercial & professional services. 202010: Commercial services & supplies; 202020: Commercial & professional services; 202030: Transportation.
25	Consumer discretionary	**2510**: Automobiles & components. 251010: Auto components; 251020: Automobiles. **2520**: Consumer durables & apparel. 252010: Household durables; 252020: Leisure equipment & products; 252030: Textiles, apparel & luxury goods. **2530**: Consumer services. 253010: Hotels, restaurants & leisure; 253020: Diversified consumer services. **2540**: Media. 254010: Media. **2550**: Retailing. 255010: Distributors; 255020: Internet & catalog retail; 255030: Multiline retail; 255040: Specialty retail.
30	Consumer staples	**3010**: Food & staples retailing. 301010: Food & staples retailing. **3020**: Food, beverage & tobacco. 302010: Beverages; 302020: Food products. **3030**: Household & personal products. 303010: Household products; 303020: Personal products.
35	Health care	**3510**: Health care equipment & services. 351010: Health care equipment & supplies; 351020: Health care providers & services; 351030: Health care technology. **3520**: Pharmaceuticals, biotechnology & life sciences. 352010: Biotechnology; 352020: Pharmaceuticals; 352030: Life Sciences tools & services.

40	Financials	**4010**: Banks. 401010: Commercial banks; 401020: Thrifts & mortgage finance; **4020**: Diversified financials. 402010: Diversified financial services: 402020: Consumer finance; 402030: Capital markets. **4030**: Insurance. 403010: Insurance. **4040**: Real estate. 404010: Real estate – discontinued; 404020: Real estate investment trusts (REITs); 404030: Real estate management & development.
45	Information technology	**4510**: Software & Services. 451010: Internet software & services; 451020: IT services; 451030: Software. **4520**: Technology hardware & equipment. 452010: Communications Equipment; 452020: Computers & peripherals; 452030: Electronic equipment & components; 452040: Office electronics; 452050: Semiconductor equipment & products – discontinued. **4530**: Semiconductors & semiconductor equipment. 453010: Semiconductors & semiconductor equipment.
50	Telecommunication services	**5010**: Telecommunication services. 501010: Diversified telecom-munication services; 501020: Wireless telecommunication services.
55	Utilities	**5510**: Utilities. 551010: Electric utilities; 551020: Gas utilities; 551030: Multi- utilities; 501040: Water utilities; 501050: Independent power producers & energy traders.

Table 2.5 Standard & Poor's and MSCI Barra's Global Industry Classification Standards (GICS)

All 16 countries –8 in Europe, 7 in Asia plus Canada– in the present research sample are duly covered by GICS. It reports 10 sectors, 24 industry groups, 68 industries and 154 sub-industries. Industry groups, with four digits, and industries –six digits– are included in the third column of the following table, but analysis in the present thesis uses only the first two digits.

Numbers of companies identified in each country –per sector– are shown in Table 2.6, where only the sector for one company in Japan is missing. Sectors with more representation are Materials, Industrials and Consumer discretionary, with above 200 companies each, and Telecommunication services with 175, while the industry in the sample with fewer firms reports 35 operating in telecommunications services.

At the country level, Asian nations (Hong Kong, Japan and Taiwan) and Canada are heavily represented in the sample –with more than 100 companies each– while Portugal is in the bottom line with 10 listed companies and no operations in four sectors: Consumer staples, health care, financials and information technology. Spain has no representation in Consumer staples, health care and financials as well but the rest of the countries do have activities in almost all of the ten sectors grouped in the Global Industry Classification Standard (GICS), so a transversal comparison might be easily achieved.

	GICS Code	10	15	20	25	30	35	40	45	50	55	
ISO	Sector	Energy	Materials	Industrials	Consumer	Consumer	Health	Financials	Information	Telecomm.	Utilities	
3166	COUNTRY				discretionary	staples	care		technology	services		TOTAL
BE	Belgium	0	1	1	1	3	1	2	0	1	2	12
CA	Canada	38	35	18	12	10	3	5	6	4	7	138
DE	Germany	0	6	2	6	2	4	1	2	1	2	26
ES	Spain	2	2	8	2	0	0	0	2	2	4	22
FR	France	2	4	7	8	3	2	0	2	1	3	32
GB	Great Britain	5	8	12	16	10	4	7	2	2	5	71
HK	Hong Kong	15	33	29	20	16	21	15	12	3	14	178
IN	India	3	7	1	3	2	3	1	4	1	1	26
JP	Japan	3	34	45	36	13	8	5	26	4	5	179
KR	Korea	3	14	19	13	8	1	1	7	3	2	71
NL	Netherlands	3	3	1	1	3	1	0	3	1	0	16
PH	Philippines	3	1	2	3	3	0	5	0	2	4	23
PT	Portugal	1	2	1	4	0	0	0	0	1	1	10
SE	Sweden	1	2	9	4	2	2	1	2	2	0	25
TH	Thailand	6	3	2	7	4	2	2	0	6	3	35
TW	Taiwan	1	57	54	69	15	5	14	107	1	0	323
	Total	86	212	211	205	94	57	59	175	35	53	1.187

Table 2.6 Number of companies per country / sector

Observations per country are provided in Table 2.7 where it is noticeable Hong Kong, Japan and Thailand –three Asian countries– represent 57,4% of the observations in the sample, so variables that are significant in these three countries may bias the results.

GICS Code	COUNTRY	OBSERVATIONS	%
BE	Belgium	132	1,0%
CA	Canada	1.518	11,6%
DE	Germany	286	2,2%
ES	Spain	242	1,9%
FR	France	352	2,7%
GB	Great Britain	781	6,0%
HK	Honk Kong	1.958	15,0%
IN	India	286	2,2%
JP	Japan	1.980	15,2%
KR	Korea	781	6,0%
NL	Netherlands	176	1,3%
PH	Philippines	253	1,9%
PT	Portugal	110	0,8%
SE	Sweden	275	2,1%
TH	Thailand	3.553	27,2%
TW	Taiwan	132	1,0%
TOTAL		13.068	100

Table 2.7 Frequencies per country

Additionally, rest of the countries help balancing the difference and Canada –with 11,6%– is not that far away from the 15% in Hong Kong and the 15,2% in Japan, even where Thailand accounts for a 27,2%, almost the sum of the other two Asian countries.

Due to the restrictions to include only those listed firms' with complete data for the analysed period, U.K. and Korea show 781 observations each and France less than half of those –352 observations– while the other ten countries in the sample show less than 300 observations, a fact that may also bias the results.

However, more than thirteen thousand observations are considered a sufficient sample, not to be affected by above mentioned issues.

Table 2.8 confirms Materials, Industrials and Consumer Discretionary relevance in the sample, because those sectors account for a 53%.

Total shows 99,9% because, as already mentioned, it was not possible to determine the sector for one Japanese company.

However, industries whose accounting practices have been traditionally more observed reflect a below 8% weight, so the results may be inversely affected by the observations in Energy with 7,2%, Financials with 5%; Utilities with 4,5% and Telecommunication Services with 2,9%.

GICS Code	INDUSTRY	OBSERVATIONS	%
10	Energy	935	7,2%
15	Materials	2.332	17,9%
20	Industrials	2.321	17,8%
25	Consumer discretionary	2.255	17,3%
30	Consumer staples	1.034	7,9%
35	Health care	627	4,8%
40	Financials	649	5,0%
45	Information technology	1.925	14,7%
50	Telecommunication services	385	2,9%
55	Utilities	583	4,5%
Total		13.057	99,9%

Table 2.8 Frequencies per industry

Except for Spain, with an 18% from their total in the Utilities sector as well as Belgium and Thailand who, as derived from data in table 2.9, report 17% each from their totals in Utilities and Telecommunications Services sectors, respectively, rest of the countries in the sample are more concentrated on sectors 10 to 45.

Almost all countries in the sample reflect 3 or 4 sectors accounting for percentages above the 50%.

Only 2 countries show a concentration above 30% on just one sector: Sweden, with 40% in Materials, and Taiwan with 33% in IT.

		COUNTRIES							
		BE	CA	DE	ES	FR	GB	HK	IN
GICS Code	INDUSTRY	Belgium	Canada	Germay	Spain	France	Great Britain	Honk Kong	India
10	Energy	0	407	0	22	22	55	165	33
15	Materials	11	385	66	22	44	88	363	77
20	Industrials	11	198	22	88	77	132	319	11
25	Consumer discretionary	11	132	66	22	88	176	220	33
30	Consumer staples	33	110	22	0	33	110	176	22
35	Health care	11	33	44	0	22	44	231	33
40	Financials	22	55	11	0	0	77	165	11
45	Information technology	0	66	22	22	22	22	132	44
50	Telecommunication serv.	11	44	11	22	11	22	33	11
55	Utilities	22	77	22	44	33	55	154	11
TOTAL		132	1518	286	242	352	781	1958	286

		COUNTRIES							
		JP	KR	NL	PH	PT	SE	TH	TW
GICS Code	INDUSTRY	Japan	Korea	Netherlands	Philippines	Portugal	Sweden	Thailand	Taiwan
10	Energy	33	33	33	33	33	11	66	11
15	Materials	374	154	33	33	11	22	33	627
20	Industrials	495	209	11	11	22	11	22	594
25	Consumer discretionary	396	143	11	11	33	44	77	759
30	Consumer staples	143	88	33	33	33		44	165
35	Health care	88	11	11	11			22	55
40	Financials	55	11			55		22	154
45	Information technology	286	77	33	33				1.177
50	Telecommunication serv.	44	33	11	11	22	11	66	11
55	Utilities	55	22				11	33	
TOTAL		1969	781	176	176	253	110	385	3553

Table 2.9 Frequencies per country and industry

Additionally, only 2 sectors in Spain –Industrials (36%) and Utilities (18%)– total 54% and 2 in Korea –Industrials (27%) and Materials (20%)– account for 47%.

2.3. MEASUREMENT OF THE VARIABLES IN THE THESIS.

2.3.1. Cultural dimensions.

Social systems can exist because human behaviour is somewhat predictable –not totally random– when both, individual and situation, are taken simultaneously into account.

It is so because it is assumed that each individual actions are stable over time and causes the same person shows a more or less similar behaviour in similar situations, based on his specific mental programming.

Hofstede considered it is not possible to directly observe the mental programming of individuals; but behaviours can indeed be examined, therefore, earnings management is hereby considered a cultural manifestation to be linked to specific countries-cultural dimensions scores, industries and legal systems, and before empirically testing the proposed hypotheses, frequencies for data gathered in this thesis sample are consequently identified now.

- Power Distance.

Lowest score, in Hofstede's 110 countries sample, belongs to Austria –with 11– and the highest ones –110 points– go to Malaysia and Slovak Republic so, even where those countries are not in the present research sample, median is fixed at 57,5 for the related analysis.

BELOW 57,5		
ISO 3166	COUNTRY	PDI
CA	Canada	39
DE	Germany	35
GB	Great Britain	35
JP	Japan	54
NL	Netherlands	38
ES	Spain	57
SE	Sweden	31

ABOVE 57,5		
ISO 3166	COUNTRY	PDI
BE	Belgium	65
FR	France	68
HK	Hong Kong	68
IN	India	77
KR	Korea	60
PH	Philippines	94
PT	Portugal	63
TH	Thailand	64
TW	Taiwan	58

Table 2.10 PDI differences among countries in the sample

People in Canada, close enough to the bottom with a 39 score, and the rest of the countries in the left box are anticipated to be sufficiently driven by PDI characteristics and might use less earnings management, in order to respect hierarchies and follow rules prepared by those who have the power.

Nine countries in the right box, exceeded the average but Taiwan, with a 58 score, and Korea, with 60, might not differentiate by PDI issues, while in the rest of the countries people there –mainly top managers– would try to find different ways of dealing with earnings management, as a manifestation of their hierarchical power within the firm and mostly in the Philippines where, definitely, their closeness to the upper limit might strongly affect related decisions.

- Individualism.

This dimension shows Guatemala's score is 6 and the USA reports 91 but, again, these two countries are not part of this study sample and in this case the middle score stands at 48,5.

Number of countries is almost balanced here but, in the left box, IDV cultural motivations in India and Spain are not clear because they are too close to the middle as to state –like it is for the other seven nations therein– people shall avoid earnings management minding about possible negative effects for the internal firm's groups, the firm or the society.

BELOW 48,5		
ISO 3166	**COUNTRY**	**IDV**
HK	Hong Kong	25
IN	India	48
JP	Japan	46
KR	Korea	18
PH	Philippines	32
PT	Portugal	27
ES	Spain	51
TH	Thailand	20
TW	Taiwan	17

ABOVE 48,5		
ISO 3166	**COUNTRY**	**IDV**
BE	Belgium	75
CA	Canada	80
DE	Germany	67
FR	France	71
GB	Great Britain	89
NL	Netherlands	80
SE	Sweden	71

Table 2.11 IDV differences among countries in the sample

People in those seven countries in the box at the right, even in Germany, France and Sweden with the lowest scores here but who are 18,5 and 22,5 points away from the middle, would manage earnings mainly if it is good for the individual deciding about those issues.

- Masculinity.

Sweden, a country in the present research sample, shows the lowest score in Hofstede's one: 5. The highest score is, like in PDI, for the Slovak Republic and the middle point this time is also 57,5.

BELOW 57,5		
ISO 3166	COUNTRY	MAS
BE	Belgium	54
CA	Canada	52
ES	Spain	42
FR	France	43
HK	Hong Kong	57
IN	India	56
KR	Korea	39
NL	Netherlands	14
PT	Portugal	31
SE	Sweden	5
TH	Thailand	34
TW	Taiwan	45

ABOVE 57,5		
ISO 3166	COUNTRY	MAS
DE	Germany	66
GB	Great Britain	66
JP	Japan	95
PH	Philippines	64

Table 2.12 MAS differences among countries in the sample

People in countries in the left box –except for Belgium, Hong Kong and India, where those reflect MAS effects not in a strong way– shall not manage earnings as it is not a natural extension of their actions, mainly in Sweden, and because of their feminine values predomination they shall disclose a large volume of financial, social and environmental information; but those four in the box at the right would manipulate, based on competitiveness and in order to reach specific goals.

- Uncertainty avoidance.

This cultural dimension's centre is at 60 and it has been clearly identified, by previous researchers mentioned in the present thesis, as one direct and positively related to accounting uniformity, conservatism and secrecy, the best to be found where UAI shows high scores, but inversely related to accounting professionalism, meaning that attribute will be higher where UAI ranks low.

BELOW 60		
ISO 3166	COUNTRY	UAI
CA	Canada	48
GB	Great Britain	35
HK	Hong Kong	29
IN	India	40
NL	Netherlands	53
PH	Philippines	44
SE	Sweden	29

ABOVE 60		
ISO 3166	COUNTRY	UAI
BE	Belgium	94
DE	Germany	65
ES	Spain	86
FR	France	86
JP	Japan	92
KR	Korea	85
PT	Portugal	104
TH	Thailand	64
TW	Taiwan	69

Table 2.13 UAI differences among countries in the sample

There is, however, lack of consensus in the direction of the secrecy relation because some of those researchers (Salter and Newslander, 1995) found significant positive relation between secrecy and uncertainty avoidance, i.e. there is less financial disclosure in strong uncertainty avoidance countries, while others (Zarzeski, 1996 and Nazh, 2011) expressed a negative correlation between uncertainty avoidance and financial disclosure exists.

So, in general, people in countries in the left box may try to take advantage of earnings management in a “creative” or “innovative” way if possible because, as Hofstede stated, “more will be left to the discretion of the organisation or even of the accountant”.

Countries in the box at the right –with the only doubt associated with Thailand– shall play strictly by the rules, but might look for accounting flexibility, and definitely might do it more in Portugal, to create safety zones, downwards or upwards, depending on their expectations.

- Pragmatism.

Puerto Rico reports a 0 value and Korea 100 points, while the long-short term orientation of people involved in earnings management decisions is considered, in the present study, that might result even more significant than the UAI cultural dimension.

BELOW 50		
ISO 3166	COUNTRY	PRA
CA	Canada	36
ES	Spain	48
PH	Philippines	27
PT	Portugal	28
TH	Thailand	32

ABOVE 50		
ISO 3166	COUNTRY	PRA
BE	Belgium	82
DE	Germany	83
FR	France	63
GB	Great Britain	51
HK	Hong Kong	61
IN	India	51
JP	Japan	88
KR	Korea	100
NL	Netherlands	67
SE	Sweden	53
TW	Taiwan	93

Table 2.14 PRA differences among countries in the sample

It is then anticipated that people in those countries in the left box may be tempted to look for immediate results and shall manage earnings more frequently, except for Spain with a score too close to the middle. Then, except for Great Britain, India and Sweden, where scores are too close to the middle as well, countries with high scores would not manipulate easily.

Countries in the box at the right tend to respect principles –like the Ruler / subject, “face”, dignity, self-respect and treat others as you would like to be treated– but they might not manipulate earnings also because they are less sensitive to earnings pressures and expect good results shall outcome later in time.

- Indulgence vs. Restraint.

Centre is located at 50 points, because Pakistan reports a 0 value and Venezuela 100 points.

People in countries with low scores, in the left box of Table 2.15 and with the exceptions of France, Thailand and Taiwan, might easily manipulate if such behaviour is associated with free gratification and a way to better enjoy life for those persons involved in earnings management decision making.

But it is important to mention they might as well look for a new job if the present one demands to manage earnings and doing so represents any kind of obligation or restriction in the mind of the one in charge of that kind of activity.

BELOW 50		
ISO 3166	COUNTRY	IVR
DE	Germany	40
ES	Spain	44
FR	France	48
HK	Hong Kong	17
IN	India	26
JP	Japan	42
KR	Korea	29
PH	Philippines	42
PT	Portugal	33
TH	Thailand	45
TW	Taiwan	49

ABOVE 50		
ISO 3166	COUNTRY	IVR
BE	Belgium	57
CA	Canada	68
GB	Great Britain	69
NL	Netherlands	68
SE	Sweden	78

Table 2.15 IVR differences among countries in the sample

It might be easier for people in countries in the box at the right to better curb personal gratification derived from earnings management, even against accepted principles derived from the Agency theory, because they might usually be controlled in their own minds by strict norms.

2.3.2 Legal systems.

The left box in Table 2.16 includes 5 countries using the Anglo-Saxon model, while the prevalence in the world for the use of the Continental system model is reflected in this research sample as well, so 11 countries in the box at the right show countries governed by it.

COUNTRY	LEGAL SYSTEM	WB RANKING
Canada	CM	6
Great Britain	CM	4
Hong Kong	CM	1
India	CM	8
Thailand	CM	36

COUNTRY	LEGAL SYSTEM	WB RANKING
Belgium	CD	57
France	CD	29
Germany	CD	49
Japan	CD	36
Korea	CD	8
Netherlands	CD	66
Philippines	CD	155
Portugal	CD	66
Spain	CD	29
Sweden	CD	14
Taiwan	CD	25

Table 2.16 Legal systems and WB ranking per country

Influence of the legal system has been already mentioned in the present thesis and it has been recognized there might be a substantial range of institutional differences among countries affecting earnings management decisions.

Thus, even where accounting standards –incorporating legal enforcement derived from the related legal system– might be formally harmonised, above mentioned differences are present in given nations.

Countries in the left box are generally viewed as outsider economies, with appropriate investor protection and, except for Thailand; they all rank among the first ten positions in the World Bank "Protecting Minority Investors" report.

Germany is typically referred to as an insider economy while others in the box at the right, like The Netherlands and Sweden, are generally viewed as being somewhere in the middle. France is considered to have very low quality in their accounting standards and almost no investor protection and, except for Korea, all those countries are poorly ranked in the World Bank report.

Using legal system as a dummy variable, in the present research, might capture tendencies of firms in specific countries to manage earnings. Then, we define the dummy variable (ANGLO) that takes the value of 1 for Anglo-Saxon countries.

2.3.3. Measurement of discretionary accruals.

For the dependent variable, the absolute value of discretionary accruals [Abs(DCA)$_{it}$] was used as a measure of the magnitude of earnings management.

This is consistent with previous studies on earnings management which point out that the study of the quality of results does not impose any direction or sign on the expectations of earnings management (Warfield *et al*. 1995; Gabrielsen *et al*. 2002; Chen *et al*. 2007; Barth *et al*. 2008).

Similarly, the original value of the discretionary accruals was used for measuring the direction of accruals (DCA).

2.3.3.1 Models identified in literature.

As previously mentioned in the present study, earnings management is considered by many researchers to be perhaps the most important item in financial statements, mostly because of its usefulness for valuing shares, so many research lines have tried to identify why managers manipulate the firm's earnings, how they do it and the ultimate consequences of their behaviour.

A wide scope of different types of earnings management is identified in literature as well as several methods to try to detect it –most of them detailed in previous pages in this thesis– but all of them face the fact that it is not possible to observe it directly, nor manager's intentions to manipulate.

Some earlier researchers reasoned managers might be interested in manipulating those figures presumably important to financial information users and focused on profits: ordinary, absolute, net or the per share ratio, trying to identify "abnormal" or "unexpected" variations –often referred to as discretionary– but, since mid-eighties, studies of managerial incentives to alter earnings have pointed out accruals relevance to do so, as those reduce problems linked to measure the effect of several accounting choices.

Total accruals, in empirical literature, are defined as the difference between net income (NI_{it}) and cash flow operations (CFO_{it}):

$$TA = NI_{it} - CFO_{it} \qquad (1)$$

Two groups may be used to discriminate between total accruals arising from usual business practices (expected) and those whose direction and magnitude is managed (unexpected), so the type of earnings may be rewritten to show decomposition where earnings equal cash flow plus expected and unexpected accruals for every firm (*i*), and firm-specific year (*t*), therefore total accruals (TA) can be calculated as follows:

$$TA_{it} = (\Delta CA_{it} - \Delta CASH_{it}) - (\Delta CL_{it} - \Delta STD_{it}) - DEP_{it} \qquad (2)$$

Where

TA_{it} = Total accruals for firm i in year t

ΔCA_{it} = Change in current assets for firm i in year t

$\Delta CASH_{it}$ = Change in cash for firm i in year t

ΔCL_{it} = Change in current liabilities for firm i in year t

ΔSTD_{it} = Change in sort-term debt for firm i in year t

DEP_{it} = Depreciation and amortisation expense for firm i in year t

Both accruals, non-discretionary and discretionary, forecasting is generated using models, so forecast errors from each of those models represent the sum of forecast errors on those two components, but some researchers (Dechow *et al.*, 1995) assumed that discretionary accruals are negligible during the estimation period.

So the model used is in effect derived from non-discretionary accruals alone and any forecast error in the period of suspected earnings management is viewed as a reasonable estimate for discretionary accruals in that period.

Therefore, some authors have tried to analyse specific accruals –in order to close the gap around managers' real intentions– like provisions for bad debts in the banking sector or claims loss reserve in the insurance industry, with an obvious disadvantage limiting generalisability to other sectors or wider samples and big differences against businesses with dissimilarities on the related regulatory constraints.

Some other works, as well, have focused on analysing the smoothing potential of discretion existing in the accounting treatment of certain transactions –non-recurring accounting items, mergers or income through dividends from subsidiaries– following accounting rules in specific countries; in pensions annual spending; in fixed assets depreciation or sale; in advertising expenses or lease-back transactions. Some others have reviewed whether earnings management tried to normalise profit as a process to reduce its variability in the long term or with a short term orientation.

Financial reports, however, may include ways to structure transactions in order to reach the managers' objectives, but those may as well show a decision by managers to accelerate, or to delay, expenditures to perform as planned, either opportunistically or with an informative perspective, that is, to mislead the market or to enhance signals for it and, in some other cases, just as a response to expected competitors' earnings management.

For the main purpose of the present research, beyond the accounting item managers would try to manipulate, the individual or market benefits that might result from such management; the accounting norms which might limit or ease such behaviour or the related term orientation, all of those should be recognised as cultural events and how those relate to Power Distance Index (PDI), Individuality (IDV), Masculinity (MAS), Uncertainty Avoidance Index (UAI), Pragmatism (PRA) and Indulgence vs. Restraint (IVR) is worthy to be assessed using a strong empirical and highly tested model.

McNichols (2000) reviewed literature from 1993 to 1999 and found out 52,8% of 55 items on earnings management use discretionary accruals as a measure of discretion. He also detected the original model of Jones (1991) is the one most frequently used in the aggregate accruals literature.

Above mentioned method is based on earlier works by Healy, in 1985, and DeAngelo, in 1986 who assessed the change in total accruals from the estimation period to proxy for expected nondiscretionary accruals in the event period. Authors considered accruals likely result from exercise of managerial discretion and changes in firm's economic conditions.

Such model relates total accruals to the change in revenues (REV) and the level of gross property, plant and equipment (PPE):

$$TA_{it} = a_{1i} + b_{1i}\, REV_{it} + c_{2i}\, PPE_{it} + 1_{it} \qquad (3)$$

Assumptions to be considered are: First, that current accruals –being those changes in working capital accounts– resulting from changes in the firm's economic environment are related to changes in revenues, or those growth since equation (3) is typically estimated with all variables deflated by either lagged assets or lagged sales and, second, that gross property, plant and equipment controls for the portions of total accruals related to nondiscretionary depreciation expense. Another version uses current accruals as dependent variable and change in revenues to explain so:

$$Current_{t} = a2_{i} + b2_{i}\, REV_{it} + 2_{it} \qquad (4)$$

Previously mentioned models are either estimated in time series firm-by-firm or in a cross-sectional way using all firms in a given two-digit industry and year. Yearly estimation, then, is used to make forecast one-year ahead of expected accruals which, subtracted from the dependent variable, yields unexpected accruals.

Based on Kaplan, from 1985, Jones developed the assumption of constant non-discretionary accruals and created a model that controls for the effect of the company's economic evolution on non-discretionary accruals. He used change in revenues to control short term normal accrual adjustments, which include accounts receivables, stock and accounts payable while incorporating gross property, plant and equipment to control for a normal level of depreciation and amortization spending.

$$TA_{it} / TA_{it-1} = a_i 1 / TA_{it-1} + b_{1i} \Delta REV_{it} / TA_{it-1} + b_{2i} PPE_{it} / TA_{it-1} + e_{it} \quad (5)$$

The previous equation (5) is fitted over an estimation period for each firm i, to provide the three parameter estimates (a_i, b_{1i} and b_{2i}) used to forecast non-discretionary accruals in prediction periods, that is why this model is considered a peek-ahead one, demanding only firms with sufficient years of non-missing data in the estimation period (10 years) to be included in the sample to be able to estimate the relation separately for each firm.

Survivorship and selection bias is incorporated by using the minimum number of firm's observations, as it is accepted companies with 10 years data tend to be the largest and more matured having, therefore, higher potential costs if the manipulative practices were discovered.

Instead of using time series data for each company, it is advisable to use annual cross-sectional data and to gather companies by sector as doing so eliminates the possible survival bias and relaxes assumption that coefficients of the revenues changes and gross fixed assets are constant for each company over time.

This way it is also assumed these coefficients are constant for the companies belonging to the same sector of activity during the same exercise.

A different model version ("industry" one) suggests that non-discretionary accruals might potentially be explained by accruals made by other firms in the same industry, recognizing each firm has certain sensitivity to industry accruals as defined below:

$$TOTACC_{it} / TA_{it-1} = i_{1i} + i_{2i} (\text{industry median } TOTACC_{it} / TA_{it-1}) + e_{it} \quad (6)$$

Equation above (6) is fitted over the estimation period for each firm i, to provide the two parameter estimates, and those are used to forecast non-discretionary accruals in prediction periods, while grouping firms into industries –using

2-digit codes– and industry medians are computed each year over all firms with non-missing values of scaled accruals.

Recent literature on earnings management recommends using cross-sectional models, because those are better than their respective time series versions, and according to Gill (2003, p. 99) –after her review on 41 papers– of total works made using these models, only 27% use the time series estimate versus 54% using only cross-sectional estimates. The remaining percentage used both approaches, but those only show results for one of them, although they always state they have obtained similar results with both.

Discretionary accruals models used in earnings management literature		
MODEL	**Papers using those**	**% over total[20]**
Healy	**9**	**21,95**
DeAngelo	**1**	**2,44**
DeAngelo-Modified	**2**	**4,87**
Jones Standard	**16**	**39,02**
Jones Modified	**15**	**36,58**
Jones Cash-flow	**5**	**9,75**
Industrial model	**1**	**2,41**
Boyton, Dobbins & Plesko	**1**	**2,41**
Cahan	**3**	**7,32**
Key	**1**	**2,44**
Magnan, Nadeau & Cormier	**1**	**2,44**
Marginal model	**1**	**2,44**
Kang & Sivaramakrishnan	**1**	**2,44**

Table 2.17 Accruals models in literature

Considering managers could accrue revenue that is in fact not yet earned and not yet received in cash, which would result in a change in revenue but also in a change in receivables, Dechow *et al.*, (1995) modified Jones original model and, after assessing the relative performance of five discretionary accrual models –Healy, DeAngelo, Jones, modified Jones and industry– they concluded that the modified version of the original Jones' model provides the most powerful tests of earnings management.

Such modification removes changes in net account receivables from the revenue changes used as explanatory variable in equation (4), arguing that earnings management might influence reported revenue figures and such an adjustment mitigates the effect of earnings management on this explanatory variable.

Coefficients to be estimated are the same in the Jones model and in the Jones standard but, to calculate estimated normal accruals adjustments; the change in accounts receivables (ΔREC) is subtracted from the change in revenues (ΔREV), in a second step.

Using aggregate discretionary accruals adjustments seems to be the best option where hypotheses to be contrasted are not focusing on a particular sector because, as already mentioned, in this last case there is a variable which can clearly be used by management to manipulate significantly.

2.3.3.2 Model used in this thesis and variables definitions.

The statistical approach in measuring discretionary accruals in the present research is based on the modified Jones (1991) model, so main details follow.

Total accruals (TA) are measured as the change in noncash working capital (excluding current maturities of long-term debt) less total depreciation expense for the current period in year *t*, scaled by total assets at year *t-1*; that is:

$$TA_t = [\ (\Delta CA_t - \Delta CASH_t\ ) - (\Delta CL_t - \Delta CMLTD_t\ ) - DEP_t\ ]\ /\ A_{t-1} \qquad (7)$$

Where

TA_t = Total accruals in year *t*

ΔCA_t = Change in current assets in year *t*

$\Delta CASH_t$ = Change in cash in year *t*

ΔCL_t = Change in current liabilities in year *t*

$\Delta CMLTD_t$ = Change in current portion of long-term debt in year *t*

DEP_t = Depreciation and amortisation expense in year t

A_{t-1} = Total assests at the end of year t-1

While non-discretionary accruals for firm i in year t (NDA_{it}) as:

$$NDA_{it} = \alpha_{it}\ (1 / A_{it-1}) + \beta_{1it}\ (\Delta REV_{it} / A_{it-1} - \Delta REC_{it} / A_{it-1}) + \beta_{2it}\ (PPE_{it} / A_{it-1}) \quad (8)$$

Where

ΔREV_{it} = Change in revenue for firm i in year t

ΔREC_{it} = Change in net receivables for firm i in year t

PPE_{it} = Gross property, plant and equipment for firm i at the end of year t

α_{it}, β_{1It}, β_{2it} = Firm-specific parameters for firm i in year t

Parameters –α_{it}, β_{1It} and β_{2it}– for each firm i in year t are estimated using the Global Industry Classification Standards (GICS) two digits code for firm j's data ($j \neq i$):

$$TA_{jt} = \alpha_{it}\ (1 / A_{jt-1}) + \beta_{1it}\ (\Delta REV_{jt} / A_{jt-1} - \Delta REC_{jt} / A_{jt-1}) + \beta_{2it}\ (PPE_{jt} / A_{jt-1}) \quad (9)$$

Discretionary accruals for i in year t (DA_{it}) are defined as:

$$DA_{it} = TA_{it} - NDA_{it}$$

Accordingly, the model to be tested takes the following form:

$$DA_{it} = b_0+b_1DE_{it-1}+b_2ASSET_{it-1}+b_3TR_{it}+b_4PDI_i+b_5IDV_i+b_6MAS_i+b_7UAI_i+b_8PRA_i+b_9IVR_i+ b_{10}DI_i+b_{11}EMS_i+\varepsilon_{it} \quad (10)$$

Where:

DE_{it-1} = Book debt to book equity ratio for firm i at the end of year t-1

$ASSET_{it-1}$ = Total assets (in millions of U.S. dollars) for firm i at the end of year t-1

TR_{it} = effective tax rate for firm i in year t

PDI_i = Power Distance index score of firm i (from Table 2.4)

IDV_i = Individualism index score of firm i (from Table 2.4)

MAS_i = Masculinity index score of firm i (from Table 2.4)

UAI_i = Uncertainty Avoidance index score of firm i (from Table 2.4)

PRA_i = Pragmatism index score of firm i (from Table 2.4)

IVR_i = Indulgence vs. Restraint index score of firm i (from Table 2.4)

DI_i = Disclosure score (from Leuz *et al*., 2003)

EMS_i = Earnings management score (from Leuz *et al*., 2003)

ε_{it} = Random error term

$b_0 \ldots b_{11}$ = model parameters

Issues to be tested are:

A. Direction and magnitude of earnings management.

When both are tested, the expected signs of the coefficients are:

$b_1 > 0$,

$b_2 < 0$,

$b_3 < 0$,

b_4 no direction,

b_5 no direction,

$b_6 < 0$,

$b_7 < 0$,

$b_8 < 0$,

b_9 no direction,

$b_{10} < 0$.

B. When only the magnitude –based on the absolute value of earnings management– is tested, the expected signs of the coefficients are:

$b_1 > 0$,

$b_2 < 0$,

$b_3 < 0$,

$b_4 > 0$,

$b_5 > 0$,

$b_6 < 0$,

$b_7 < 0$,

$b_8 < 0$,

$b_9 < 0$,

$b_{10} < 0$,

Expected relationships between the effect of each of the six Hofstede's cultural dimensions with the magnitude and direction of earnings management are as follows:

Effect on	PDI	IDV	MAS	UAI	PRA	IVR
Magnitude of EM	+	+	+	?	--	?
Direction of EM	?	?	?	--	--	?

Notes:

(–) Represents negative relationship

(+) Represents positive relationship

Table 2.18 Magnitude and direction signs for this thesis

We expect results of our empirical test to be consistent with prior studies on the debt/equity ratio, size and tax rates issues; to confirm high scores in PDI, IDV and MAS relate to more earnings management –upwards or downwards– as well as about a higher magnitude in countries with low disclosure and earnings management scores and a decrease in accounting accruals in countries showing high UAI scores.

More important, because this thesis focus in a relevant way in the following new issues, we anticipate:

- This test shall identify there will more earnings management where pragmatism (PRA) scores are low and, simultaneously, prove this fifth Hofstede's cultural dimension shows better forecasting attributes than the traditionally UAI dimension.
- Provide elements to support IVR affect earnings as well.
- Contribute to determine legal systems do moderate the association between Hofstede's dimensions and discretionary accruals.

CHAPTER 3

Empirical Results

In this chapter we will show the descriptive results as well as the univariate and multivariate analysis of our thesis.

We, like others, used data by Leuz *et al*. (2003) for some of the 31 countries they reported, as well as a ten years period, and controlled for the institutional differences, such as outside investor rights –obtained from the anti-director rights index by La Porta *et al.* (1998)– and legal enforcement, again an average of the efficiency of the judicial system, the degree of corruption, and the degree of legal enforcement, and a distinction between code-law and common-law countries.

3.1. DESCRIPTIVE STATISTICS.

Data for six cultural dimensions; Earnings Management Score (EMS); Disclosure Index (DI) and the traditional independent variables: Debt to equity ratio (DE), total assets (ASSET) and effective tax rate (TR) are shown in Table 3.1, where IDV, UAI and PRA show the higher standard deviations.

	Minimum	Maximum	Average	Std. Dev.
PDI	31	94	55,74	12,485
IDV	17	89	41,16	25,574
MAS	5	95	55,43	19,949
UAI	29	104	61,89	22,436
PRA	27,4559	100	71,0033	23,1306
IVR	16,9643	77,6786	45,123	16,6284
EMS	5,3	26,8	17,8606	6,5555
DI	36	83	67,14	5,832
DE	0	640,8673	33,1459	24,0649
ASSET	0	133.260.000,00	875.831,65	4.245.136,07
TR	0	95.150,00	31,2858	835,9539
DA	0,001	15,549	0,5703	1,4238

Table 3.1 Descriptive variables statistics

As we can see in the discretionary accruals per country (Table 3.2), discretionary accruals (absolute value of discretionary accruals as dependent variable) average is higher for France.

Such a result was expected because of the previous cultural comments in this study about their PDI and IDV approach and consistent with the UAI expectations, about safety zones creation.

However their behaviour is contrary to their MAS and PRA characteristics, evidencing femininity and long-term issues are not that strong when earnings management decisions are involved, while IVR was supposed to have no effect, because score is too close to the centre, but it does.

India, with the second highest accruals average, acts consistently with their PDI, UAI and IVR scores and cultural intentions derived from IDV, MAS and PRA were not clear enough, based on their score, but there is evidence now that people there do manipulate.

Country		Minimum	Maximum	Average	Std. Dev.
BE	Belgium	0,003	9,918	0,6297	1,5387
CA	Canada	0,001	14,989	0,6005	1,6314
DE	Germany	0,002	15,249	0,8557	2,0521
ES	Spain	0,001	9,03	0,341	0,9278
FR	France	0,002	9,688	1,1288	1,9285
GB	Great Britain	0,001	11,105	0,5021	1,2302
HK	Honk Kong	0,001	15,164	0,7701	1,7422
IN	India	0,004	14,156	1,0914	2,1756
JP	Japan	0,001	9,893	0,3203	0,6763
KR	Korea	0,001	13,78	0,6087	1,6135
NL	Netherlands	0,001	11,904	0,6242	1,5925
PH	Philippines	0,002	13,107	0,8246	1,86
PT	Portugal	0,005	4,426	0,536	0,8634
SE	Sweden	0,001	11,537	0,5261	1,4635
TH	Thailand	0,001	6,792	0,4879	0,9496
TW	Taiwan	0,001	14,598	0,4815	1,2182

Table 3.2 Discretionary accruals per country

Japan and Spain report the lowest averages and these two countries belong to the same cultural groups in PDI and UAI expected to manage earnings less.

Cultural motivations were not clear for Spain due to closeness of their IDV score to the centre, but it is confirmed herewith they do not manage that much.

These two countries are placed in different groups based on their MAS scores, but Spain evidenced here people's feminine predomination there tends to avoid earnings management while Japan shows masculinity imperatives are not that strong, as they show low accruals average in this analysis.

Something similar happens with PRA, as Japan and Spain belong to different cultural groups as well, and the first one was anticipated would not manipulate easily – something which is herewith confirmed– but the score for Spain, almost at the centre of the dimension, left doubts about temptations to look for immediate results, which was not evidenced in the present thesis analysis.

IVR grouped both countries with a penchant for manipulation but, recalling a comment about the possibility to avoid it where such an activity represents an obligation or restriction for people managing earnings; it seems to be the case in Japan and Spain.

Discretionary accruals per year (absolute value of discretionary accruals as dependent variable) evidence earnings management averages increased, in an important way, in years 2004 and 2005, perhaps as a response to the rising of oil prices crisis which started at the end and beginning of those periods.

Year	Minimum	Maximum	Average	Std. Dev.
2003	0,001	15,249	0,550185	1,4925915
2004	0,001	15,148	0,782855	1,795521
2005	0,001	14,989	0,800349	1,9254336
2006	0,001	14,254	0,571225	1,4018698
2007	0,001	14,567	0,541677	1,3343246
2008	0,001	12,697	0,534292	1,2567922
2009	0,001	14,854	0,531292	1,3835337
2010	0,001	14,487	0,481373	1,2149991
2011	0,002	11,867	0,491001	1,1671564
2012	0,001	12,314	0,534506	1,3103243
2013	0,001	11,845	0,461682	1,1340374

Table 3.3 Discretionary accruals per year

The U.S. subprime credit crisis seems to be reflected in the averages slope shown since 2008, curbing appetite for accruals manipulation as well as an almost “back to normal” cultural behaviour in 2012, when global economic situation was supposed to enhance, only to go down again in 2013 when forecasting was complicated once more.

As a complementary analysis, the sample was divided into two groups according to the Anglo-Saxon or Continental legal system used in each country.

	ANGLO-SAXON				CONTINENTAL			
VARIABLES	Minimum	Maximum	Average	Std. Dev.	Minimum	Maximum	Average	Std. Dev.
PDI	35	77	55,7	12,04	31	94	55,82	13,271
IDV	17	89	37,94	28,235	18	80	47,13	18,291
MAS	34	66	50,83	7,631	5	95	63,94	30,243
UAI	29	69	51,67	16,852	29	104	80,77	18,959
PRA	32	93	67,321	23,4699	27	100	77,8114	20,8436
IVR	17	69	45,9807	18,6878	29	78	43,5369	11,7558
EMS	5,3	22,5	16,9961	6,9323	6,8	26,8	19,4589	5,4448
DI	57	78	68,42	4,928	36	83	64,79	6,59
ASSET	0	3623570	40583,962	149663,308	0	1,33E+08	2420138,53	6901536,04
TR	0	95150	30,4065	1034,7947	0	5624,07	32,9115	105,52
DE	0	640,867	29,6026	24,0843	0	124,693	39,6971	22,6133
DA	0,001	15,164	0,5912	1,4673	0,001	15,249	0,5318	1,3394

Table 3.4 Variables per legal system

It is observed mean values of the IDV, MAS, UAI and PRA cultural dimensions are higher in the Continental than in the Anglo-Saxon system.

PRA, in the Anglo-Saxon model, shows the higher average above UAI and the rest of the cultural dimensions as expected. The temporal horizon of people using accruals seems to be definitely more relevant in those countries where this legal system rules. Moreover, for those using the Continental model UAI average proves to be the main issue, but PRA follows closely.

It is accepted investor legal rights are stronger in nations high on IDV, as individualism legitimises the vigorous pursuit of personal interests, rather than deference to others’ decisions and interests.

UAI affects the way power in organisations is exercised. High UAI is consistent with giving power to authorities who control uncertainty and with perceiving conflict in the corporation as unnatural. Low UAI is compatible with readiness on the part of corporate constituencies to challenge one another—in general meetings, in public media, and in the courts—with indeterminate outcome.

The important issue now will be to test how the cultural dimensions relate to earnings management in those countries included in the sample, depending on their Earnings Management and Disclosure scores; their size and other financial aspects; the respective industries and the legal systems.

3.2 UNIVARIATE ANALYSIS.

For an exploratory analysis, the sample was divided into two groups depending on the level of the PDI dimension: a group of firms with the proportion of PDI over the median value and the group of firms with the proportion of PDI under the median value. The same pattern applies to IDV, MAS, UAI, PRA, IVR, EMS and DI dimensions.

Then, a test of means comparison was conducted to explore whether discretionary accruals (DA) are different between both groups. Table 3.5 reports the results.

	DA		
	Under median	**Over median**	***p*-value**
PDI	**0.4798**	**0.7576**	**0.000*** **
IDV	**0.5812**	**0.5588**	**0.373**
MAS	**0.5517**	**0.5944**	**0.093***
UAI	**0.6042**	**0.4814**	**0.000*** **
PRA	**0.6796**	**0.4643**	**0.000*** **
IVR	**0.5901**	**0.5519**	**0.129**
EMS	**0.5954**	**0.5263**	**0.008*** **
DI	**0.5011**	**0.6867**	**0.000*** **

Table 3.5 Univariate analysis

Although not conclusive, the findings suggest that cultural dimensions are related to discretionary accruals.

More specifically, the magnitude of DA is higher in those groups where PDI, MAS, EMS and DI dimensions are over the media but, as well (p<0.01), UAI and PRA are significant being under the median.

3.3. REGRESSIONS WITH THE MAGNITUDE OF DISCRETIONARY ACCRUALS.

First, Table 3.6 shows the results of the regressions, with the Abs DCA as the dependent variable after using only one of each dimension, and a positive influence on the magnitude of discretionary accruals.

The magnitude test demanded regressions, variable by variable, for the whole sample and the incorporation of a dummy (ANGLO = 1), that takes the value of one of the Anglo-Saxon countries:

	-1	-2	-3	-4
PDI	**0.003****			
	(0.247)			
IDV		**0.004*****		
		(8.178)		
MAS			**-0.006*****	
			(-9.226)	
UAI				**-0.008*****
				(-11.762)
LnASSETS	**0.095*****	**0.118*****	**0.112*****	**0.114*****
	(15.014)	**(17.805)**	**(17.697)**	**(18.149)**
TR	**0.002*****	**0.000**	**0.000**	**0.000**
	(2.867)	**(-0.367)**	**(-0.114)**	**(-0.229)**
DE	**-0.004*****	**0.001*****	**0.002*****	**0.001*****
	(-0.752)	**(1.448)**	**(3.628)**	**(1.443)**
ANGLO	**0.410**	**0.527*****	**0.395*****	**0.226*****
	(11.917)***	**(14.456)**	**(11.563)**	**(5.989)**
Years	**YES**	**YES**	**YES**	**YES**

	-5	-6	-7	-8
PRA	**0.004*** **			
	(6.721)			
IVR		**0.000**		
		(-0.290)		
EMS			**-0.019*** **	
			(-8.927)	
DI				**0.006*** **
				(2.706)
LnASSETS	**0.129*** **	**0.097*** **	**0.121*** **	**0.101*** **
	(19.389)	**(15.009)**	**(18.131)**	**(16.085)**
TR	**0.000**	**0.000**	**0.000**	**0.000**
	(0.002)	**(-0.215)**	**(-0.384)**	**(-0.246)**
DE	**0.000**	**0.001*** **	**0.001*** **	**0.001*** **
	(-0.392)	**(2.792)**	**(1.443)**	**(2.620)**
ANGLO	**0.440*** **	**0.419*** **	**0.451**	**0.409*** **
	(12.945)	**(12.141)**	**(13.194)**	**(11.880)**
Years	**YES**	**YES**	**YES**	**YES**

***, **, and * indicated confidence at the 99 percent, 95 percent, and 90 percent levels. Absolute value of discretionary accruals as dependent variable.

Table 3.6 Regression on the magnitude of DA

Except for the IVR score, all variables are statistically significant and a strong relationship between the cultural dimensions and disclosure practices (DI), expressed – at least for the first four of those dimensions– by Gray (1988); Perera (1989); Doupnik & Salter (1995); Salter & Niswander (1995); Gray & Vint (1995); Pourjalali and Meek (1995); Zarzeski (1996); MacArthur (1996); Lainez and Gasca (2006); Tsakumis *et al*. (2007); Han *et al*. (2010) and Nazh (2011), among others, is confirmed.

Results are also similar to those obtained by Guan and Pourjalali (2010), for the first four cultural dimensions they used in their analysis, and linkages between the six dimensions and Grays's accounting dimensions, reviewed by Borker (2013), are established as well.

Then the model was tested again, using all the dimensions. However, EMS was deleted due to collinearity problems:

	Expected sign	
PDI	+	0.015***
		(7.956)
IDV	+	0.016***
		(11.979)
MAS	+	-0.010***
		(-11.357)
UAI	?	-0.004***
		(-2.630)
PRA	_	0.002**
		(2.442)
IVR		-0.004***
		(-2.131)
DI		-0.014***
		(-3.433)
LnASSETS		0.156***
		(22.154)
TR		0.000
		(-0.235)
DE		0.001
		(0.436)
ANGLO		0.606***
		(12.145)
Years		YES
F		16.094
N		12837

Table 3.7 Pooled regression after deleting EMS

It is confirmed –after the second regression– all variables, this time even IVR, are statistically significant. UAI and PRA show lower scores and the link between cultural dimensions and DI is reconfirmed. Additionally, expected signs were coincident to those mentioned in this thesis (see Table 2.18) for the cultural issues.

3.4 ROBUSTNESS ANALYSIS.

Now we repeat the regressions by using alternative models of discretionary accruals. Specifically and following previous literature we will use Jones modified CP model, Jones Standard and Jones Standard CP model. Results verify previous findings and confirm that the influence of culture is independent of the model used to measure discretionary accruals.

	JonesModCP	JonesStandard	JonesStandardCP
PDI	0.017***	0.017***	0.058***
	(-8559)	(-7896)	(-10052)
IDV	0.013***	0.017***	0.013***
	(-9323)	(-11814)	(-10586)
MAS	-0.010***	-0.009***	-0.010***
	(-10.464)	(-9.581)	(-11.551)
UAI	-0.004***	-0.005***	-0.004***
	(-3.040)	(-3.351)	(-2.617)
PRA	0.003**	0.002**	0.002**
	(-2450)	(-2202)	(-1835)
IVR	-0.002	-0.001	-0.002
	(-1.207)	(-0.463)	(-1.060)
DI	-0.010**	-0.015***	-0.009**
	(-2.486)	(-3.431)	(-2.228)
ANGLO	0.447***	0.574***	0.475***
	(-8633)	(-10495)	(-9962)
LnASSETS	0.127***	0.155***	0.145***
	(-17385)	(-20055)	(-21536)
TR	0.000	0.000	0.000
	(-0.219)	(-0.360)	(-0.206)
DE	0.000	-0.002***	0.000
	(0.078)	(-3588)	(0.802)
Years	YES	YES	YES
F	25.797	31.495	34.405
N	12869	12845	12890

***, **, and * indicated confidence at the 99 percent, 95 percent, and 90 percent levels. Absolute value of discretionary accruals as dependent variable.

Table 3.8 Regression with alternative models of discretionary accruals

3.5 REGRESSIONS WITH THE DIRECTION OF DISCRETIONARY ACCRUALS.

The model is now regressed using the original value of discretionary accruals in order to test the direction of discretionary accruals. PRA shows no significance, but the rest of the variables do, while the signs are quite different except for the PRA one. Like Guan and Pourjalali (2010) realised, PDI, IDV and MAS all have a significant effect of the direction of earnings management.

	Expected sign	
PDI	?	-0.005**
		(-2.412)
IDV	?	-0.011***
		(-7.664)
MAS	?	0.010***
		(10.392)
UAI	_	-0.010***
		(-6.805)
PRA	_	0.001
		(1.237)
IVR		0.017***
		(8.980)
DI		-0.031***
		(-7.198)
LnASSETS		-0.082***
		(-10.745)
TR		0.000
		(0.053)
DE		-0.004***
		(-6.257)
ANGLO		-0.456***
		(-8.476)
Years	YES	
F		18959
N		12847

***, **, and * indicated confidence at the 99 percent, 95 percent, and 90 percent levels. Absolute value of discretionary accruals as dependent variable.

Table 3.9 Directional test

However, as previously mentioned in the present research, several authors discovered significant positive effect of UAI on manipulation but nothing clear enough for the other three cultural dimensions as to venture a direction estimate.

Previous studies on earnings management (Warfield *et al*. 1995; Gabrielsen *et al*. 2002; Chen *et al*. 2007; Barth *et al*. 2008) have pointed out that the study of the quality of results does not impose any direction or sign on the expectations of earnings management.

3.6. THE MODERATING ROLE OF LEGAL SYSTEMS.

In this section, we want to test if the results regarding the effect of culture on earnings management are moderated by the legal tradition of the country. Then, the sample was divided according to related legal system and using discretionary accruals absolute values as well as only one of each dimension in the first round. We remember the classification of countries in the following table:

COUNTRY	LEGAL TRADITION
Belgium	CD
Canada	CL
France	CD
Germany	CD
Great Britain	CL
Hong Kong	CL
India	CL
Japan	CD
Korea	CD
Netherlands	CD
Philippines	CD
Portugal	CD
Spain	CD
Sweden	CD
Taiwan	CD
Thailand	CL

Table 3.10 Legal traditions

Then the effect on the objective variables, on the magnitude of discretionary accruals, is tested. We will see the individual effect of each dimension in each group of countries. As we can see in Tables 3.11 and 3.12, all the variables are significant, confirming their importance as mentioned by Licht *et al*. (2005) as well as Matoussi & Jardak (2012). Nevertheless, there are differences between both legal systems.

One of the main differences between both groups occurs in the PDI dimension, that is, power distance. As we can see in Anglo-Saxon countries there is a negative association. Then, people in these countries use less earnings management, in order to respect hierarchies and follow rules prepared by those who have the power.

On the other side, in Continental countries, people would try to find different ways of dealing with earnings management, as a manifestation of their hierarchical power within the firm. Then, in these countries where the protection is lower, the higher the power distance, the higher the level of discretionary accruals.

CONTINENTAL MODEL

	-1	-2	-3	-4
PDI	0.005**			
	(3.498)			
IDV		0.007***		
		(5.222)		
MAS			-0.006***	
			(-8.187)	
UAI				-0.006***
				(-5.695)
LnASSETS	0.013	0.046***	0.042***	0.032***
	(1.592)	(4.587)	(-0.536)	(3.733)
TR	0.000	0.000	0.000	0.000
	(-1.101)	(-1.383)	(-0.563)	(-0.964)
DE	0.000	0.000	0.001	0.001
	(0.375)	(-0.233)	(1.534)	(1.126)
Years	YES	YES	YES	YES

	-5	-6	-7	-8
PRA	-0.010***			
	(-7.557)			
IVR		0.004**		
		(1.957)		
EMS			-0.023***	
			(-5.58)	
DI				0.002
				(0.556)
LnASSETS	0.072***	0.097***	0.039**	0.014*
	(6.529)	(15.009)	(4.271)	-1726
TR	0.000	0.000	0.000	0.000
	(-0.015)	(-0.215)	(-1.255)	(-0.165)
DE	-0.001	0.001	0.000	0.001
	(-0.667)	(2.792)	(0.212)	(0.442)
Years	YES	YES	YES	YES

***, **, and * indicated confidence at the 99 percent, 95 percent, and 90 percent levels.
Absolute value of discretionary accruals as dependent variable.

Table 3.11 Continental model regression

ANGLO-SAXON MODEL

	-1	-2	-3	-4
PDI	-0.005***			
	(-3.816)			
IDV		0.004***		
		(7.230)		
MAS			0.016***	
			(7.504)	
UAI				-0.008***
				(-8.646)
LnASSETS	0.221***	0.228***	0.218***	0.216***
	(21.664)	(22.925)	(22.727)	(22.676)
TR	0.000	0.000	0.000	0.000
	(0.067)	(-0.017)	(0.084)	(0.058)
DE	0.000	0.000	0.000	-0.001
	(0.720)	(-0.266)	(-0.345)	(-0.955)
Years	YES	YES	YES	YES

	-5	-6	-7	-8
PRA	-0.005***			
	(-7.297)			
IVR		-0.001		
		(-0.701)		
EMS			-0.020***	
			(-8.314)	
DI				0.030***
				(0.860)
LnASSETS	0.219***	0.205***	0.236**	0.244***
	(22.791)	(20.967)	(23.281)	(23.455)
TR	0.000	0.000	0.000	0.000
	(-0.030)	(0.121)	(-0.052)	(0.019)
DE	0.000	0.001	0.000	-0.001
	(-0.715)	(1.041)	(-0.619)	(-0.882)
Years	YES	YES	YES	YES

***, **, and * indicated confidence at the 99 percent, 95 percent, and 90 percent levels.
Absolute value of discretionary accruals as dependent variable.

Table 3.12 Anglo-Saxon model regression

With regards to Masculinity (MAS), we observe that Masculinity will increase earnings management only in countries located in Anglo-Saxon areas.

Another difference is with respect to the long term orientation, which is the Pragmatism dimension (PRA). We see that the higher the pragmatism the lower the earnings management, but only in Anglo-Saxon countries, where this dimension is more developed.

The negative effect of Uncertainty Avoidance on earnings management is not influenced by the legal tradition and indulgence (IVR) shows no significance for the Anglo-Saxon model.

Finally, disclosure (DI) reduces manipulation in Anglo-Saxon areas. Then, the higher the disclosure the lower the manipulation, but only in those countries where the transparency is higher.

	Continental	**Anglosaxon**
PDI	+	-
IDV	+	+
MAS	-	+
UAI	-	-
PRA	-	-
IVR	-	-
DI	NS	+

Table 3.13 Summary of regressions results by legal tradition

CHAPTER 4

Final Remarks, Limitations and Future Research

Financial and economic crisis, together with the high profile corporate collapses in 2003-2004 and the subprime crisis, among other financial scandals, have led to a debate concerning the quality of reported earnings and financial reporting, and raised the question of how to improve the financial and economic stability worldwide. In this context the role played by culture and its influence on the quality of accounting information is an area on which there are still many questions.

As a direct consequence, target set in this paper is:

A. To assess the impact of culture on earnings management. We studied the effect on magnitude and direction of discretionary accruals using the Modified Jones model and alternative models to verify robustness of our results.
B. To extend previous researches, on above mentioned topic, assessing the impact of new Hofstede's cultural dimensions index, so far not formerly evaluated in previous literature, have on earnings management.
C. To find out whether the Anglo-Saxon and Continental legal systems, linked to culture, affect earnings management, acting as moderator variables.

To do so we used an international sample of 16 countries and 1188 listed companies during the years 2002-2013.

The present work is framed within the earnings management research line which, since the early nineties, has been documenting motives, techniques, restrictions and research designs for the benefit of different users of accounting information: shareholders, creditors, regulators, auditors, investors, analysts, etc.

From the previous four categories, emerged from a top selected journals literature review, motives for earnings management represent the topic with the highest percentage: 33%.

That category, as well, was the one with more papers empirically based, but very few of those focused on analysing culture and legal systems as important motivators, even where people actions, related to financial figures manipulation, might derive mainly from those two.

Therefore, considering only a few authors started, in the recent past, to directly associate accounting to cultural and legal country-specific factors, combining those three aspects assessed in the present thesis –cultural dimensions, earnings management and legal systems– can yield insights obscured by using one approach alone.

This research, which considers the above mentioned three aspects, can contribute to a better understanding of the cultural dimensions and legal systems effects on managers' distortionary actions on the information disclosed by them and may help developing effective market disciplines by explaining cross-country differences in the level of earnings management.

The concept of Culture

After conducting a review of the literature on various aspects of the concept of culture, it was identified that it has been present among sociologists and anthropologists since the nineteenth century.

It has been broadly defined in terms of certain processes commonly shared, like shared ways of thinking, feeling and reacting among its members.

Its definitions tend to include almost anything in the environment of human beings that is not immutably determined by nature.

The first academic definition accepted in 1871 said: "Culture is that complex whole which includes knowledge, beliefs, arts, morals, laws, customs and any other competition and habit acquired by [a human] as a member of society."

Most of the research of the past years focused on the changing characteristics of respective values, attitudes and beliefs to conclude that most people tend to consider the generated rules in their own culture as relatively permanent aspects in their personal systems values, so it is different from country to country.

Importance of national culture has become increasingly important in the last decades, largely as a result of the classic work of Hofstede (1980), who asserts that mental programs of people around the world do not change rapidly, but remain rather consistent over time and his is the most widely used national cultural framework in psychology, sociology, marketing, or management studies.

Considering it is not possible to directly observe the mental programming of individuals, behaviours can indeed be examined, meaning words and deeds of people, to infer –from them– the presence of stable mental programs; as in physics the intangible concept of force is inferred from its manifestations in the movement of objects.

Hofstede developed scores for 110 geographically separate entities and for each of the six cultural dimensions, which are: PDI, Power Distance Index; IDV, Individualism; MAS Masculinity; UAI, Uncertainty Avoidance Index; PRA, Pragmatism and IVR, Indulgence vs. Restraint.

Researchers have favoured the Hofstede's cultural dimensions framework due to its clarity, parsimony and resonance with management and because much empirical research has been published in top-tier scientific journals as well as in journals specialised in international management and psychology.

Culture and the accounting systems

An important area, then, of cultural values that have been investigated is the potential role of culturally derived national accounting values on the quality of financial reporting.

Accounting systems, in the broadest sense, were defined by Jarne (1997) as "the set of factors intrinsic to the system –internal agents– that, through the modelling they are subject to through their own interrelationships and external influences –outside agents– conform a properly structured "whole", capable of meeting needs assigned to the accounting function in different areas”.

Due to historical differences between accounting systems internationally, as a result of the search for adequate answers to social demands from each country and the multitude of factors that influence them, it is clear that a response to similar problems is shown in different ways, with the particular combination of factors specific to each country –and, in a relevant way, the corresponding cultural impact– which also generates a unique system.

To simplify description and comparison of different existing accounting systems in the world, according to their attributes, the purpose of the main demand aimed at all accounting system is taken into consideration: incorporation of useful accounting information, into the economic system, for their users.

Every accounting system, as a whole, allows the particularised analysis of groups at a country level as per the similarity in each of the subsystems and observing differences in each.

Arguably the first important research, among those linking accounting to culture, is Gray's work (1988), who proposes the existence of four accounting values: Professionalism versus Statutory Control; Uniformity versus Flexibility; Conservatism versus Optimism and Secrecy versus Transparency.

Previous literature proves the study of relationships between accounting and culture is not a new or small issue, but one that has been researched since the last century, which prevents the issue of disinterest in the chosen topic and the lack of literature on this subject as these studies have found that Gray's theoretical model contributes statistically significant explanatory power to both areas.

Gray argued that the most important societal values, at the accounting subculture level, would be the Uncertainty Avoidance Index (UAI) and Individualism (IDV), while the Power Distance Index (PDI) and Masculinity (MAS) would only be significant to some degree, and further relates that MAS would be even less important in the accounting system.

Only recently, Borker (2013) expanded the relationship between Gray accounting value dimensions and Hofstede cultural dimensions by including links to Hofstede's fifth and sixth dimensions, something we have also done in the present research. These dimensions are included in our research and analysed for the first time, not only on their relationship with earnings management, but also in their different behaviour regarding the legal tradition of the country where the company is located.

Culture and legal systems

Researchers agree there is a strong link between cultural values and legal systems, where the secondly mentioned relate to the operating set of legal institutions, procedures and rules which regulate a given society as well as to the way law should be originated, applied, studied, perfected and taught, with either a common or civil law origin.

It has been recognised, in first instance, that where common law applies it contains a set of prohibitions setting limits on individual behaviour and, simultaneously, a high degree of freedom that empowers and strengthens the interpretation of rules.

In countries where civil law applies, laws, codes and rules stipulate the minimum standards that determine the expected behaviour of citizens and the accounting aspect often becomes a matter of national legislation, detailing the accounting practices approach.

Influence of the legal environment, and its enforcement, show cross-country differences in investor protection from various perspectives, as well as on the quality of accounting standards, because laws differ markedly around the world, though in some places they tend to give investors a rather limited bundle of rights while in some others it might protect the potential financiers against expropriation by entrepreneurs.

La Porta *et al*. (2001), among others, found out legal protection of investors in a country is an important determinant of the development of its financial markets and provided support for the quantitative importance of the expropriation of minority shareholders in many countries, as well as for the role of the law in limiting such expropriation.

Those authors assessed the relationship between legal origins and investor protection and their theory has greatly broadened to include many other areas while concluding that common law countries grow faster than civil law countries.

The World Bank has been interested in what makes countries able to generate growth, enforce investment, secure property rights, and provides public order and built and index of investor protection confirming, except for Thailand, that common law countries in their sample ranked among the first ten.

It has been recently evidenced (Matoussi & Jardak, 2012) that cultural environment existing in many developing and transition economies, where investor protection cannot be protected within a proper court system, like those existing in Asia, which developed social norms that do not rely on litigation certainly have other mechanisms of governance than those known in the West.

Culture and earnings management

There is significant empirical research that seeks to document earnings management in order to determine causes and consequences, Therefore, the cultural dimensions in which they are performed differ from one country to the other and initial differences can be seen as well through the two main legal systems.

Notwithstanding such facts, only a few authors directly started in the recent past to associate accounting to cultural and legal country-specific factors.

While the possible impact of culture and accounting values, as well as legal systems, on earnings management remains under-researched and how, why or where they relate is equally important as describing which key variables matter. Thus, although previous research has examined the effect of certain cultural dimensions in the magnitude of accruals, no study to date has examined whether the effect of the cultural dimensions (including those new added to Hofstede's index) may be conditional by the Anglo-Saxon or Continental legal system.

Culture and financial information linkage. Main findings

Literature shows important differences among countries as well as positive and negative associations between culture and corporate governance, investor protection, earnings management direction and magnitude, earnings discretion, smoothing and manipulation so most works conclude culture is an important determinant of accounting choice.

Comparing each of the six Hofstede's cultural dimensions characteristics, specifically applied to earnings management, is useful to identify preferable accounting and financial disclosure practices to then assume their "meaning" in different countries as well as their predictive powers, given that each of these dimensions have the dual character mentioned below.

PDI (Power Distance Index) implies related decisions may be centralised in the hands of top management or incorporating lower hierarchy positioned interests. IDV (individuality), as well, reflects CEOs personal interests and their individual judgement may prevail where earnings management is to be decided, but there may also be a consensus decision involved.

Assertiveness and material success may drive earnings management decision based on MAS (Masculinity) while femininity may improve the earnings quality of firms.

Financial disclosure is quite different depending on UAI (Uncertainty Avoidance Index) and the ambiguity perception of people related to earnings discretion or smoothing and PRA (Pragmatism) motivations differ with relation to the short or long-term vision of earnings management users.

IVR (Indulgence versus Restraint), though relatively new, has begun to be researched and its relation with earnings management differs depending on what happiness means for the individual and whether the pursue of such a goal is limited by conscious decisions.

This research evidences power distance, individualism and masculinity dimensions increase the magnitude of earnings management. Managers in countries with low levels of individualism (high levels of collectivism) might be more inclined to use earnings discretion to protect the welfare of the collective group of firm stakeholders.

Similarly, intentionally dampening earnings in periods when earnings are high might be inconsistent with a desire on the part of management to demonstrate achievement and success.

Uncertainty avoidance results in downwards earnings management. Moreover, our findings show that the higher the disclosure the lower the magnitude of earnings management, suggesting that less manipulation takes place when transparency is higher. These findings support new business trends to be more reporting transparent to investors and society in general. Our results also show a positive association between firm size and earnings management. Sensitivity analysis used with Jones modified CP model, Jones Standard model and Jones Standard CP model confirm the robustness of these results.

Additionally this thesis test if there are differences in the above results by testing the moderating role of the Legal tradition (Continental versus Anglo-Saxon). Our results confirm differences in several dimensions and, consequently, the legal system moderating role in the culture and earnings management association.

With regards to Power distance, the results suggest that –culturally– managers in Anglo-Saxon countries use less earnings management, in order to respect hierarchies and follow rules prepared by those who have the power. On the other side, in Continental countries, managers would try to find different ways of dealing with earnings management, as a manifestation of their hierarchical power within the firm.

Our findings denote in these countries where the protection is lower, the higher the power distance, the higher the level of discretionary accruals. Furthermore, we see that the increasing effect of Individualism on earnings management does not depend on the legal tradition of the country. So, apparently, the cultural driving force is more closely related to what the individual or group main interests might be rather that what the legal system structure englobes.

In addition, our results show that the increasing effect of Masculinity on earnings management only takes place in Anglo-Saxon environments, because those are more used to a preference for achievement, assertiveness and material success, these three being typical cultural attributes of this dimension. Likewise, the Pragmatism dimension only decreases the magnitude of earnings management in Anglo-Saxon countries, where the values of this dimension are higher due to their superior long-term orientation.

In addition, the positive effect of disclosure in reducing the magnitude of earnings management seems not to have effect on Continental countries. This result is of great interest as it reveals the transparency effect in decreasing accrual adjustments only affects Anglo-Saxon environments, where investor protection is superior.

At the country level analysis some of our empirical findings confirm, for example, that France showed the highest average for discretionary accruals, something consistent with their civil law characteristic –weakest investor protections– as well as with the power concentration; rejection to individualities and a way to think changes derive from revolution; a different way to focus on success, depending on whether people belongs to upper or lower classes; a need for laws, but not to follow them and the truth concept depending on the situation, context and time.

In short, the four most important conclusions of this thesis, given its innovative approach, are:

1. The thesis helps building theories documenting that both culture and legal tradition impact on earnings management and by validating the importance of the cultural dimension related to pragmatism (PRA).

2. We also identified power distance (PDI) in the Anglo-Saxon system shows a negative relationship (related to the respect for hierarchies and those people with power) versus a power demonstration within the firm, which derives in more earnings management in countries of the Continental System.

3. It was further found that masculinity (MAS) increases earnings management only in countries of the Anglo-Saxon system, while a higher level of pragmatism (PRA) and disclosure (DI) decrease manipulation in this system, originated from the existence in the respective countries of a long-term scope and proper transparency.

4. It was shown, as well, that the negative effect of the uncertainty avoidance (UAI) is not influenced by the legal tradition.

This attempt to empirically assess the relationship among culture, legal systems and earnings management has some imitations, the most important one derived from a 57.4% of the observations in the sample are based on Asian countries, which culturally are more related to a long term orientation and may bias the results.

Our investigation, nonetheless, reveals earnings management is impacted by cultural dimensions –and in a more important way by Uncertainty Avoidance Index and Pragmatism, while the other four dimensions do show some effect– which tendencies vary in different ways, for both geographical and legal systems perspectives.

We believe that our research findings provide strong direct and empirical evidence of the effect of cultural values on earnings management on an international and wide temporal scope. Similarly our results confirm that when we analyse the effect of culture on earnings management is necessary to take into account the legal tradition of the countries.

Our results represent a significant contribution to the earnings management research area, being explanatory for many of the mixed results of those studies that have analysed the effect of culture on earnings management in different cultural environments.

If cultural context is to be recognised as one of the relevant earnings management motivators, the present research can be useful in smoothing the path towards advancing forward, to better understand and handle more specifically detailed relationships among its dimensions, the legal systems and country profiles in order to predict how those affect financial information users.

Our future extension of this thesis is to examine the effect of culture in different time periods, distinguishing between pre- and post-crisis years. Similarly, we plan to test the effect of the investor protection as another moderating factor in the association between culture and earnings management.

Additionally, we shall be able to relate recommended changes in techniques and tools that may help regulation enforcement in specific countries, starting with those in our sample, based on the cultural characteristics detected in the power distance (PDI), masculinity (MAS) and pragmatism (PRA) high or low scores and the corresponding increased earnings management behaviour which can be seen in the following tables, as this will contribute to improve information quality and consequently markets efficiency.

COUNTRY	PDI	COUNTRY	PDI	COUNTRY	PDI	COUNTRY	PDI
Belgium	65	Japan	54	Philippines	94	Spain	57
France	68	Korea	60	Portugal	63	Taiwan	58

COUNTRY	MAS	COUNTRY	MAS
Canada	65	Hong Kong	54
Great Britain	68	India	60

COUNTRY	PRA
Canada	36
Thailand	32

CAPÍTULO 4

Comentarios finales, limitaciones e investigación futura

Las crisis financieras y económicas, junto con los colapsos corporativos de alto perfil en 2003-2004 y la crisis de las hipotecas de alto riesgo, entre otros escándalos financieros, han llevado a un debate concerniente a la calidad de la divulgación de los resultados y de la divulgación financiera y han generado la cuestión acerca de cómo mejorar la estabilidad financiera y económica a nivel mundial. En este contexto el papel jugado por la cultura y su influencia en la calidad de la información contable es un área sobre la que existen aún muchos interrogantes.

Como consecuencia directa, el objetivo fijado para esta tesis es:

A. Evaluar el impacto de la cultura en la gestión de los resultados. Estudiamos el efecto en la magnitud y dirección de los devengos discrecionales utilizando el modelo de Jones Modificado y empleando modelos alternativos para comprobar la robustez de nuestros resultados.
B. Ampliar investigaciones previas, sobre el tema arriba mencionado, evaluando el impacto que nuevas dimensiones del índice cultural de Hofstede, hasta ahora no evaluadas con anterioridad en literatura previa, tienen sobre la gestión de resultados.
C. Descubrir si los sistemas legales Anglosajón y Continental, vinculados a la cultura, afectan la gestión de los resultados, actuando como variables moderadoras.

Para ello utilizamos una muestra internacional de 16 países y 1188 empresas cotizadas durante los años 2002-2013.

El presente trabajo se enmarca dentro de la línea de investigación de la gestión de los resultados la cual, desde inicios de los noventa, ha estado documentando motivaciones, técnicas, restricciones y diseños de investigación en beneficio de diferentes usuarios de la información contable: accionistas, acreedores, reguladores, inversionistas, analistas, etc.

De las previas cuatro categorías, tras la revisión de la literatura en una selección de revistas científicas de primer nivel, las motivaciones para gestionar los resultados representan el tema con el mayor porcentaje: 33%.

Esa categoría, así mismo, fue la de mayor cantidad de artículos empíricamente basados, pero muy pocos se enfocaron en analizar la cultura y los sistemas legales como motivadores importantes, a pesar de que las acciones de las personas, relacionadas con la manipulación de cifras financieras, pudiera derivar principalmente de esas dos.

En consecuencia, considerando que apenas unos cuantos autores, en el pasado reciente, comenzaron a asociar directamente lo contable con factores culturales y legales específicos de los países, combinar esos tres aspectos –dimensiones culturales, gestión de los resultados y sistemas legales– evaluados en el presente documento puede evidenciar perspectivas ocultas al usar solamente un enfoque.

Esta investigación, que contempla los tres aspectos arriba mencionados, puede contribuir a mejorar la comprensión de los efectos de las dimensiones culturales y los sistemas legales en las acciones distorsivas de la gerencia en cuanto a la información divulgada por aquella y puede ayudar a desarrollar disciplinas efectivas de mercado al explicar las diferencias entre países en el nivel de la gestión de los resultados.

El concepto de Cultura.

Después de haber revisado la literatura en cuanto a diversos aspectos del concepto de cultura, se identificó que ha estado presente entre los sociólogos y antropólogo desde el siglo XIX.

Ha sido ampliamente definido en términos de ciertos procesos comúnmente compartidos, como formas compartidas de pensar, sentir y reaccionar entre sus miembros.

Sus definiciones tienden a incluir casi cualquier cosa en el entorno de los seres humanos que no resulte inmutablemente determinado por la naturaleza.

La primera definición académica aceptada en 1871 decía: "*La cultura es ese complejo todo que incluye conocimiento, creencias, artes, moral, legislación, costumbres y cualquier otra competencia y hábito adquirido por [un humano] como miembro de la sociedad.*"

La mayor parte de la investigación de los años pasados se enfocó en las cambiantes características respectivas de valores, actitudes y creencias para concluir que la mayoría de la gente tiende a considerar las reglas generadas en su propia cultura como aspectos relativamente permanentes en su personal sistemas de valores, así que resulta diferente de país a país.

La importancia de la cultura nacional se ha convertido crecientemente importante en las últimas décadas, en buena medida como resultado de la obra clásica de Hofstede (19880), quien asevera que los programas mentales de la gente alrededor del mundo no cambian rápidamente, sino que permanecen consistentes con el paso del tiempo– y el suyo es el marco cultural nacional mayormente utilizado en psicología, sociología, mercadotecnia o estudios de administración.

Considerando que no es posible observar directamente la programación mental de los individuos, los comportamientos sí que pueden ser examinados, refiriéndose a las palabras y actos de la gente, para inferir –a partir de ellos– la presencia de programas mentales estables, igual que en física el concepto intangible de fuerza se infiere por su manifestación en el movimiento de los objetos.

Hofstede desarrolló puntajes para 110 entidades geográficamente diferentes y para cada una de las seis dimensiones culturales, que son: PDI, Índice de Distancia del Poder; IDV, Individualismo; MAS, Masculinidad; UAI, Tendencia a Evitar la Incertidumbre; PARA, Pragmatismo e IVR, Indulgencia vs. Restricción.

Los investigadores han favorecido el cuadro de dimensiones culturales de Hofstede debido a su claridad, parsimonia y resonancia con la gerencia y porque mucha investigación empírica se ha publicado en revistas científicas de alto nivel de administración y psicología aplicada así como en revistas especializadas en administración internacional y psicología.

La cultura y los sistemas contables.

Una importante área, por tanto, de los valores culturales que ha sido investigada es el rol potencial que tienen los valores nacionales contables derivados de la cultura sobre la calidad de la divulgación financiera.

Los sistemas contables, en el sentido más amplio, los definió Jarne (1997) como "el conjunto de factores intrínsecos al sistema –agentes internos– que, mediante el modelaje al que son sujetos por conducto de sus propias interrelaciones y de las influencias del exterior –agentes externos– conforman un "todo" apropiadamente estructurado, capaz de satisfacer las necesidades asignadas a la función contable en diferentes áreas".

Debido a las diferencias históricas entre los sistemas contables a nivel internacional, como resultado de la búsqueda de respuestas adecuadas a las demandas sociales de cada país y a la multitud de factores que las influencian, resulta claro que la respuesta a problemas similares se muestra en diferentes formas, con la combinación de factores específica para cada país –y, en forma relevante, el correspondiente impacto cultural– lo cual también genera un sistema único.

Para simplificar la descripción y comparación de los diferentes sistemas contables que existen, en función de sus atributos, el propósito de la principal demanda impuesta a todos los sistemas contables se toma en consideración: la incorporación de información contable útil, dentro del sistema económico, para sus usuarios.

Todo sistema contable, como un todo, permite el análisis particularizado de grupos a nivel países, de conformidad con la similitud en cada uno de los subsistemas y observando las diferencias en cada uno.

Sin duda la primera investigación importante, entre las que vinculan la contabilidad con la cultura, es la obra de Gray (1988), quien propone la existencia de cuatro valores contables: Profesionalismo versus Control Estatutario; Uniformidad versus Flexibilidad; Conservadurismo versus Optimismo y Secreto versus Transparencia.

La literatura previa evidencia que el estudio de las relaciones entre contabilidad y cultura no es una situación nueva ni menor, sino una que ha venido siendo investigada desde el siglo pasado, lo cual impide el asunto de desinterés en el tema elegido y la falta de literatura sobre éste ya que estos estudios han demostrado que el modelo teórico de Gray contribuye estadísticamente a un significativo poder explicativo en ambas áreas.

Gray argumentó que los más importantes valores societarios, a nivel de la subcultura contable, serían el Índice de la Tendencia a evitar la Incertidumbre (UAI) y el Individualismo (IDV), mientras que el Índice de Distancia del Poder (PDI) y la Masculinidad (MAS) sólo serían significativos hasta cierto grado, y posteriormente relata que MAS sería todavía menos importante en el sistema contable.

Solamente en fechas recientes, Borker (2013) amplió la relación entre las dimensiones de los valores contables de Gray y las dimensiones culturales de Hofstede al incluir vínculos a la quinta y sexta dimensiones de Hofstede. Estas dimensiones son incluidas en nuestro trabajo y analizadas por primera vez, no sólo en su relación con la gestión de resultados, sino también en su diferente comportamiento respecto a la tradición legal del país donde se encuentra la empresa.

La cultura y los sistemas legales.

Los investigadores están de acuerdo en que existe un fuerte vínculo entre los valores culturales y los sistemas legales, para el cual los mencionados en segundo término se relacionan con el conjunto operativo de instituciones legales, procedimientos y normas que regulan a una sociedad en particular así como a la forma en la que la legislación debe originarse, aplicarse, estudiarse, perfeccionarse y enseñarse, ya sea con un origen basado en el derecho común o civil.

Se ha reconocido, en primera instancia, que donde aplica el derecho común éste contiene una serie de prohibiciones que fijan los límites de la conducta individual y, simultáneamente, un grado de libertad que empodera y fortalece la interpretación de las normas.

En países donde aplica el derecho civil, las leyes, códigos y normas estipulan el mínimo estándar que determina el comportamiento esperado de los ciudadanos y el aspecto contable con frecuencia se convierte en un asunto de legislación nacional, que detalla la perspectiva de las prácticas contables.

La influencia del entorno legal, y su observancia, muestran diferencias entre los países en la protección al inversionista desde varias perspectivas, así como en la calidad de la normatividad contable, debido a que las normas difieren marcadamente en el mundo, aunque en algunos lugares tienden a proporcionar a los inversionistas un conjunto más bien limitado de derechos mientras que en algunos otros puede proteger a los potenciales financiadores contra la expropiación por parte de los empresarios.

La Porta *et al.* (2001), entre otros, descubrieron que la protección a los inversionistas en un país es un importante determinante del desarrollo de sus mercados financieros y proporcionaron sustento para la importancia cuantitativa de la expropiación de los accionistas minoritarios en muchos países, así como para el rol de la legislación para efectos de limitar tal expropiación.

Estos autores evaluaron la relación entre los orígenes legales y la protección al inversionista y su teoría ha sido ampliada considerablemente para incluir muchas otras áreas en tanto que concluyeron que los países que aplican derecho común crecen más rápido que los países de derecho civil.

El Banco Mundial ha estado interesado en identificar qué hace a los países capaces de generar crecimiento, hacer valer la inversión, garantizar los derechos de propiedad y proveer orden público así que construyó un índice de protección al inversionista confirmando que, excepto por Tailandia, los países que aplican derecho común en su muestra estaban posicionados entre los diez primeros.

Sin embargo, los orígenes legales y la calidad de las leyes no han sido capaces de explicar todas las diferencias en la estructura de propiedad y los modelos de gobierno corporativo en el mundo, en tanto que los factores culturales parecen ser importantes para explicar las diferencias en el gobierno corporativo y los patrones propietarios.

Se ha detectado recientemente (Matoussi y Jardak, 2012) que el entorno cultural existente en muchas economías en desarrollo y transición, donde la protección al inversionista no puede ser cobijada dentro de un sistema judicial apropiado como los existentes en Asia los cuales desarrollaron normas sociales que no descansan sobre el litigio, tienen a decir verdad otros mecanismos de gobernanza distintos a los conocidos en Occidente.

La Cultura y la gestión de los resultados.

Existe investigación empírica significativa que busca documentar la gestión de los resultados a fin de determinar causas y consecuencias. Así, las dimensiones culturales en las cuales se desempeñan difieren de un país a otro y las diferencias iniciales pueden observarse también a través de los dos principales sistemas legales.

A pesar de esos hechos, solamente unos pocos autores comenzaron directamente en el pasado reciente a asociar la contabilidad con factores culturales y legales específicos de los países.

En tanto que el posible impacto de los valores culturales y contables, al igual que los sistemas legales, sobre la gestión de los resultados permanece sub-investigada y cómo, por qué o dónde se relacionan es igual de importante que describir cuáles variables clave importan. Así, aunque investigaciones previas han examinado el efecto de ciertas dimensiones culturales en la magnitud de los ajustes de devengo, ningún estudio hasta la fecha ha analizado si el efecto de las dimensiones culturales (incluidas las nuevas agregadas al índice de Hofstede), pueden estar condicionadas por el sistema legal Anglosajón o Continental.

La Cultura y el vínculo con la información financiera. Principales hallazgos

La literatura evidencia diferencias importantes entre países así como asociaciones positivas y negativas entre la cultura y el gobierno corporativo, la protección al inversionista, la dirección y magnitud de los devengos discrecionales, la discrecionalidad de los resultados, alisamiento y manipulación de forma tal que la mayoría de las investigaciones llegan a la conclusión de que la cultura es una determinante importante en la elección contable.

Comparar las características de cada una de las dimensiones culturales de Hofstede, específicamente aplicadas a la gestión de los resultados, resulta útil para identificar prácticas preferidas de divulgación contable y financiera para entonces asumir su "significado" en diferentes países así como sus poderes predictivos, toda vez que cada una de esas dimensiones tiene la característica dual señalada a continuación.

PDI (el Índice de Distancia del Poder) implica que las decisiones respectivas pueden estar centralizadas en manos de la alta dirección o incorporar los intereses de posiciones jerárquicas inferiores. IDV (el Individualismo), también, refleja los intereses personales del CEO y su juicio personal puede prevalecer al momento de decidir sobre la gestión de los resultados, pero también puede estar involucrada una decisión por consenso.

La asertividad y el éxito material pueden orientar las decisiones sobre la gestión de los resultados basadas en MAS (la Masculinidad) en tanto que la feminidad puede mejorar la calidad de los resultados de las empresas.

La divulgación financiera es muy diferente en función de UAI (el Índice de Tendencia a Evitar la Incertidumbre) y la percepción que tenga la gente sobre la ambigüedad relacionada con la discrecionalidad de los resultados o el alisamiento y las motivaciones de PRA (el Pragmatismo) difieren en relación con la visión de corto o largo plazo de los usuarios de la gestión de los resultados.

IVR (la Indulgencia versus la Restricción), aunque relativamente nueva, ha comenzado a ser investigada y su relación con la gestión de los resultados difiere dependiendo de lo que signifique la felicidad para el individuo y de si la búsqueda de tal meta está limitada por decisiones conscientes.

Esta investigación evidencia que las dimensiones de la distancia del poder, el individualismo y la masculinidad incrementan la magnitud de la gestión de los resultados. La gerencia en países con bajos niveles de individualismo (altos niveles de colectivismo) pudiera estar más inclinada a gestionar los resultados para proteger el bienestar del grupo colectivo de partes interesadas de la firma.

De forma similar, amortiguar intencionalmente los resultados en los períodos en los que los resultados son elevados pudiera resultar inconsistente con el deseo por parte de la gerencia de demostrar logro y éxito.

La tendencia a evitar la incertidumbre se traduce en gestión de los resultados a la baja. Lo que es más, nuestros hallazgos denotan que mientras más alta es la divulgación más desciende la magnitud de la gestión de los resultados, lo cual sugiere que se presenta menos manipulación cuando la transparencia es mayor. Estos resultados respaldan las nuevas tendencias empresariales a mostrar una mayor transparencia informativa al inversor y a la sociedad en general. Nuestros resultados también evidencian una asociación positiva entre el tamaño de la empresa y la gestión de los resultados. El análisis de sensibilidad usado con el modelo de Jones modificado a CP, el modelo estándar de Jones y el modelo estándar a CP de Jones confirman la robustez de estos resultados.

Adicionalmente esta tesis prueba si hay diferencias en los resultados comentados probando el rol moderador de la tradición legal (Continental versus Anglosajón).Nuestros resultados confirman diferencias en varias dimensiones y, en consecuencia, el papel moderador del sistema legal en la asociación entre cultura y ajustes de devengo discrecionales.

Concretamente, en relación a la Distancia del Poder, los resultados sugieren que –culturalmente– los managers en países Anglosajones utilizan menos la gestión de los resultados, a fin de respetar las jerarquías y seguir las normas preparadas por aquellos que detentan el poder. Por otra parte, en países Continentales, los managers tratan de encontrar diferentes formas de lidiar con la gestión de los resultados, como una manifestación de su poder jerárquico en el interior de la firma.

Nuestros hallazgos evidencian que en los países donde la protección del inversionista es más baja, mientras más elevada la distancia del poder, mayor el nivel de devengos discrecionales. Además, observamos que el efecto incremental del Individualismo sobre la gestión de los resultados no depende de la tradición legal del país. Así que, aparentemente, la fuerza cultural que guía se relaciona más estrechamente con cuáles puedan ser los principales intereses individuales o grupales más que con aquello que engloba la estructura del sistema legal.

Asimismo, nuestros resultados muestran que el efecto incremental de la Masculinidad sobre la gestión de los resultados solamente tiene lugar en entornos Anglosajones, porque esos están más acostumbrados por una preferencia hacia el logro, la asertividad y el éxito material, siendo estos tres atributos culturales típicos de esta dimensión cultural. Similarmente, la dimensión del Pragmatismo solamente disminuye la magnitud de la gestión de los resultados en países Anglosajones, donde los valores de esta dimensión son superiores debido a su mayor orientación al largo plazo.

Además, el efecto positivo de la divulgación para reducir la magnitud de la gestión de los resultados parece no tener efecto en los países Continentales. Este resultado es de gran interés al revelar que el efecto de la transparencia en la disminución de los ajustes de devengo sólo tiene efecto en entornos Anglosajones, donde la protección al inversor es superior.

En el análisis a nivel país algunos de nuestros hallazgos empíricos confirman, por ejemplo, que Francia denotó el mayor promedio de devengos discrecionales, algo que resulta consistente con su característica de derecho civil –protecciones más débiles del inversionista– así como con la concentración del poder; el rechazo a las individualidades y una manera de pensar que los cambios derivan de la revolución; una manera diferente de enfocarse en el éxito, dependiendo de si la gente pertenece a las clases altas o bajas; una necesidad de contar con leyes, pero no para respetarlas y del concepto de verdad que depende de la situación, el contexto y el tiempo.

En resumen, las cuatro conclusiones más importantes de esta tesis, dado su enfoque innovador, son:

1. La tesis ayuda a construir teorías al documentar que tanto la cultura como la tradición legal impactan en la gestión de los resultados y al validar la relevancia de la dimensión cultural vinculada al pragmatismo (PRA).

2. Identificamos, así mismo, que la distancia del poder (PDI) en el Sistema Anglosajón muestra una relación negativa (relacionada con el respeto a las jerarquías y

a quienes tienen poder) contra una manifestación de poder, hacia adentro de la firma, que propicia mayor gestión de los resultados en países del Sistema Continental.

3. Se detectó además que la masculinidad (MAS) aumenta la gestión de los resultados sólo en países del Sistema Anglosajón, mientras que un mayor pragmatismo (PRA) y divulgación (DI) la disminuyen en dicho Sistema, por existir en los países respectivos una visión de largo plazo y una apropiada transparencia.

4. Así mismo, se apreció que el efecto negativo de la tendencia a evitar la incertidumbre (UAI) no está influenciado por la tradición legal.

Este intento de evaluar empíricamente la relación entre la cultura, los sistemas legales y la gestión de los resultados tiene algunas limitaciones, derivando la más importante de ellas en que el 57.4% de las observaciones en la muestra se basan en países Asiáticos, los cuales están culturalmente más relacionados con la orientación a largo plazo y eso puede desviar los resultados.

Esta investigación, revela que la gestión de los resultados está impactada por las dimensiones culturales –y en forma más importante por el índice de la tendencia a evitar la incertidumbre y el pragmatismo, mientras que las otras cuatro dimensiones muestran algunos efectos– cuyas tendencias varían en formas diferentes, en función de los sistemas legales.

Creemos que los hallazgos de nuestra investigación proporcionan evidencia directa y empírica sobre el efecto de los valores culturales en la gestión de los resultados en un escenario internacional y en una amplia dimensión temporal. De forma similar nuestros resultados confirman que cuando analizamos el efecto de la cultura en la gestión de los resultados es necesario tomar en consideración la tradición legal de los países.

Nuestros resultados suponen una importante contribución al área de investigación sobre manipulación de resultados, pudiendo dar explicación a muchos de los resultados heterogéneos de aquellos trabajos que han analizado el efecto de la cultura en la gestión de resultados en entornos culturales diferentes.

Si el contexto cultural ha de ser reconocido como uno de los motivadores relevantes de la gestión de los resultados, la presente investigación puede ser útil para allanar el camino que permita avanzar, para la mejor comprensión y manejo de relaciones detalladas y más específicas entre sus dimensiones, los sistemas legales y los perfiles de país a fin de predecir cómo afectan esos a los usuarios de la información financiera.

Nuestra futura ampliación de este estudio consiste en examinar el efecto de la cultura en diferentes períodos de tiempo, distinguiendo entre años previos y posteriores a la crisis. De igual forma, planeamos probar el efecto de la protección al inversor como otro factor moderador en la asociación entre cultura y la gestión de los resultados.

Adicionalmente, podremos relacionar cambios recomendables en técnicas y herramientas que puedan ayudar al obligado cumplimiento (*enforcement*) de la normatividad en países específicos, comenzando por los de la muestra, a partir de las características culturales detectadas en los puntajes altos o bajos de la distancia del poder (PDI), la masculinidad (MAS) y el pragmatismo (PRA) y el correspondiente comportamiento relativo a la gestión de los resultados, como se puede apreciar en los siguientes cuadros, ya que eso coadyuvará a poder mejorar la calidad de la información y consecuentemente la eficiencia de los mercados.

PAÍS	PDI	PAÍS	PDI	PAÍS	PDI	PAÍS	PDI
Bélgica	65	Japón	54	Filipinas	94	España	57
Francia	68	Corea	60	Portugal	63	Taiwán	58

PAÍS	MAS	PAÍS	MAS
Canadá	65	Hong Kong	54
Gran Bretaña	68	India	60

PAÍS	PRA
Canadá	36
Tailandia	32

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