

**BETWEEN-COUNTRY VARIATIONS IN THE
APPLICATION OF THE PRINCIPLE OF AUDITOR
CONFIDENTIALITY: A EUROPEAN SETTING**

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ABSTRACT

Proponents of mutual recognition of accounting principles and auditing standards across-borders assume a minimal level of uniformity in the application of basic accounting and auditing standards. Furthermore, international accounting firms proclaim a worldwide uniformity of the services they render. The first goal of this research was to test the existence of such uniformity as it applies to the principle of auditor confidentiality when placed within a dilemma setting. The second goal was to examine the uniformity of the factors that influenced the auditor's decisions regarding their implementation of the confidentiality principle. The third goal was to examine whether any observed between-country differences in the application of auditor confidentiality or the factors that influenced that judgment could be associated with the frequently

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used cultural constructs identified by Hofstede (1984).

This research examines the importance of confidential information obtained from one client on the audit opinion expressed on a second client. The sample includes 287 partners, senior managers, managers and seniors from international auditing firms located in Denmark, Ireland, Italy, Spain, Sweden, the Netherlands, and the United Kingdom. The analysis indicated the presence of inter-country differences in auditor confidentiality. Our analysis indicates considerable between-country variation in the relative importance of the factors considered when making that decision – with some similarity based on geographic region. The analysis also indicated that the only significant Hofstede cultural construct factor associated with the noted variances was that of masculinity/femininity. The implications of these findings potentially affect the policies and claims relating to mutual between-country recognition of accounting and auditing practices.

The advocacy for greater between-country mutual recognition of accounting and auditing practices relies upon the assumption that the basic underlying principles of the standards involved will be interpreted and applied by the accounting profession throughout the various participating countries in a consistent manner. Furthermore, international accounting firms, realizing the importance to investors of a quality audit, frequently claim that their services are offered on a consistent “one-firm-worldwide” basis. In spite of both the need for and claim of consistency, it has been documented in the accounting literature that established country cultural differences do influence professional judgment (e.g. Adler, 1997; Cohen, et al., 1992, 1995; Schlegelmilch and Robertson, 1995; Sen, 1997).

One of the basic underlying principles within the practice of auditing is auditor confidentiality, which states that auditors shall not disclose, without consent, any confidential client information. In the absence of such a rule, it would be very difficult for auditors to conduct the examination needed to form a reasonable opinion as to the accuracy of the client's financial statements, since the client might be reluctant to grant access to proprietary information. While the specific wording of this principle might vary somewhat among the professional codes of conduct in different countries, the principle itself is universal.

This research uses a case study that was distributed to auditors in eight Western European countries. We examine between-country variations in responses to audit actions regarding confidentiality. We observed the auditors' application of the principle of confidentiality in a dilemma driven situation and the relative importance they place on potential causal factors in their decision making process. We then determined if any variations noted in those responses could be explained by country-specific cultural characteristics (Hofstede, 1980, 1984).

THEORY DEVELOPMENT

Mutual Recognition in the International Economy

During the past several decades, business has become more international in focus, leading to a growth in the number and size of multi-national corporations. To operate internationally and assist in financing their international operations, corporations from both developed and developing countries began to list their equity securities in the markets of multiple countries, requiring the application of multiple unique reporting requirements of the different listing countries.

The difficulties experienced by international businesses in meeting diverse financial reporting requirements of multiple listing agencies have led to the advocacy and some implementation of policies mutual recognition of accounting reporting requirements of listing firms' home country. Yet in order to protect the interest of the investing public, it is necessary that mutual recognition be

supported by minimal levels of acceptability and consistency of basic accounting and auditing principles, standards and practices found within the listing firms' home countries.

Globalization of the accounting profession

In addition to concerns relating to mutual recognition of reporting requirements, one of the central challenges facing auditing firms and auditing professionals within an increasingly global environment is how to balance the desire for their own standardized global policies and practices that facilitate the coordination and integration of their worldwide operations within the specific norms of different national and cultural contexts (Bartlett and Ghoshal, 1998; Enderle, 1997). At the center of this argument are the international accounting firms serving a large population of clients with operations distributed globally. These firms frequently claim in their advertising that they produce consistent audit services throughout the world. For instance, the Big-Four's websites include statements such as:

Deloitte Touche Tohmatsu: *A Unified Worldwide Practice -- We are focused on client service through a global strategy executed locally.*

PricewaterhouseCoopers: *Seek to provide service of consistently superior quality around the world. Connect the teams and networks of our global community through a global deployment programme, a shared code of conduct, and knowledge management and communications technologies.*

Ernst & Young: *No matter what your industry, no matter where your operations are located, we can help you through our skills and experience.*

KPMG: *With a global approach to service delivery, respond to clients' complex business challenges with services that span industry sectors and national boundaries.*

As with the call for mutual recognition, such claims by the international firms are based upon the assumption of between-

country consistency in their application of the basic principles of accounting and auditing.

Professional Judgment and Culture

As the international financial institutions face the potential problems of providing and maintaining the minimal levels of accounting and auditing consistency needed for mutual recognition and as the international auditing firms face the problems of providing uniformly consistent global practices, the reality of between-country cultural differences must be faced. Research has shown that cultural values and their differences across countries can have an impact on professional judgments within various settings. Included have been findings regarding public relations practitioners (Vasquez and Taylor, 1999), ethical reasoning (Tsui and Windsor 2001), global work values (Ryan, et al. 2000), cockpit behavior in pilots (Merritt 2000), leadership styles of managers in post-communist countries (Ardichvilli 2001), work related values and leadership styles in German and US telecommunication workers (Kuchinke 1999), and differences in the ethical perceptions of US and Mexican purchasing managers (Tadepalli, et al., 1999).

Within the context of auditing, culture has been shown to have a significant impact upon decision making for the auditor. Cultural characteristics have been found to have an impact on auditors' ethical perceptions (Cohen, et al. 1995) and on auditors' decisions regarding independence (Arnold, et al. 1999a and 1999b), materiality (Arnold, et al. 2001a and 2001b) and problems relating to underreporting on time budgets and premature sign-off on audit steps (Arnold, et al. 2002).

Thus as we see both the advocacy of policies regarding mutual recognition and the increased need for uniformity of global policies within the international accounting firms – both of which are based on the principle of minimum levels of between-country consistency – one question facing us is whether the basic auditing principles are being applied consistently in various different

countries and whether any between-country variation can be attributable to country specific cultural differences.

Confidential client information

One of the most fundamental and universal principles of auditing is that of confidentiality. For financial reporting to achieve its goal of usefulness to the stakeholder, the auditor must have access to client files and financial records when performing the attestation function. From the perspective of management, the auditor must maintain a high level of confidentiality with regard to these records and information, since their public exposure could have significant business effects on the company. Without auditor confidentiality, the client would be hesitant to reveal information relevant to the audit.

The American Institute of Certified Public Accountants (AICPA) recognizes confidentiality as imperative in its code of conduct. Section 301 addresses this principle and states that a member in public practice shall not disclose any confidential client information without the specific consent of the client (1999, 4671). Censure may result for violation of the code of conduct with punishment ranging from a fine to the permanent loss of the auditor's professional license. Similarly, the International Federation of Accountants in its Code of Ethics for Professional Accountants (1999) suggest that confidentiality of information (Section 4) is required and that accountants have an:

[O]bligation to respect the confidentiality of information about a client's or employer's affairs acquired in the course of professional services. The duty of confidentiality continues even after the end of the relationship between the professional accountant and the client or employer.

Auditors have a professional obligation to test and express an opinion on the accuracy of a client's financial statements. This process allows the investors to have accurate information about companies for use in their investment decisions. At times, however, the auditors must balance the need to serve the investing

public with the requirements of their professional Code of Conduct. A potential conflict between serving the investing public and following the Code could arise when the auditor possesses confidential information. The conflict of obligations places the auditor's duty to the financial community and the various external stakeholders on one side and the continuing client trust that is essential to the audit relationship on the other. Disclosing such information might result in the "greatest good" to the investing public, yet if the information were obtained as a result of a privileged communication, the auditor is obligated not to disclose it. Our research scenario (Appendix) is based on this conflict.

RESEARCH QUESTIONS

To examine the principle of confidentiality, this study used an audit scenario in which information relevant to an auditor's opinion of one client's financial statements was accidentally obtained through the audit of a second client. However, the second client demanded that this information not be exposed at this time. Furthermore, there did not appear to be a reasonable alternative method for the auditor to obtain this information when conducting the audit of the first client. Without the use of this information, an improper "clean" audit opinion would probably be issued for the first client.

Between-country differences in Auditors Actions

The method used for the first part of this examination (i.e. between-country differences in auditor actions and reasoning) consisted of distributing a case scenario to 287 practicing audit partners, senior managers, managers and seniors of international public accounting firms distributed over eight Western European countries. They were asked to predict the probability that the auditor would not sign-off (NSO) on a "clean" audit opinion (which was tantamount to revealing confidential information) and to identify the relative importance (on a 1 to 7 scale) of each of 12 factors or reasons (Ri) which they might have considered when

reaching that decision. See the Appendix for the complete instrument. The first four research questions asked were:

- RQ1:** Was there variation between countries in the predicted probability of the auditor taking the specific action (NSO) noted?
- RQ2:** Was there variation between countries in the relative importance assigned to the 12 factors (Ri) that the auditors might consider when reaching their audit decision (NSO) on confidentiality?
- RQ3:** Was there a relationship between the predicted probability (NSO) from RQ1 and the relative importance assigned to the 12 factors (Ri) in RQ2?
- RQ4:** Does the relationship between the predicted probability (NSO) and the relative importance assigned to the 12 factors (observed in RQ3) vary between countries?

Cultural Influences

The second part of the study examined whether any between-country variation in audit action and reasoning was attributable to cultural characteristics found within the countries of the subjects. Hofstede (1991, 112) defines culture as a "*set of likely reactions of citizens with a common mental programming... (Exact) reactions (to a common situation) need not be found within the same persons, but only statistically more often in the same society*". He believes that culture represents a system of shared values and beliefs. External and ecological factors, institutional consequences, and the societal values of a culture (Hofstede 1980) influence the process that produces accounting values and systems (Gray 1988). Arnold and Bernardi (1997), Kachelmeier and Shehata (1997), Siegel et al. (1997), and Cohen et al. (1995) all found cultural differences. Hofstede's constructs associated with the survival of international joint ventures (Barkema and Vermeulen, 1997).

Hofstede's (1980) cultural constructs were the result of sampling over 100,000 employees from the 53 countries of a large multi-national corporation. Concerns over the age of the research

and the potential of the construct not representing current cultural effects have been raised. However, data provided by Au (1999) indicates that Hofstede's constructs are still usable. The final set of research questions deals with the association between Hofstede's cultural constructs and the variables examined in RQ1 (the probability of the auditor taking the specific action noted, NSO) and in RQ2. The relative importance assigned to the 12 factors that the auditors might consider when reaching their audit decision on confidentiality.

While professionals are influenced by the culture in which they live and work, accounting systems have also developed in response to the specific characteristics of a country's environment. Radebaugh in a study of Peru (1975) suggested that different accounting systems developed as a result of the interactions and compromises between various environmental factors including: the type of economy, the stage of economic development, the nature and development of corporate capital, the regulatory framework, and cultural attitudes (1975). Gray's (1988) accounting values and systems development is influenced by external and ecological factors, institutional consequences and societal values of a culture. More recently, Collins and Bloom (1997) posited that the development of an accounting system may be a result of the country's culture. Hofstede (1980) suggests that the dimensions related to national culture are: Individualism, Power Distance, Uncertainty Avoidance, and Masculinity/Femininity.⁴ Hofstede (1984, 83-84) describes these four constructs as:

Strong versus Weak Uncertainty Avoidance: The degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. Strong Uncertainty Avoidance societies (for example) maintain rigid codes of belief and behavior and are intolerant towards deviant

⁴ Hofstede (1991) added a fifth construct of Long/Short Term Orientation; however, he also indicates that there needs to be an East-West contrast for this construct to come into play.

persons and ideas.

Individualism versus Collectivism: *Individualism stands for a preference for a loosely knit social framework in society. The fundamental issue addressed by this dimension is the degree of interdependence a society maintains among individuals.*

Large versus Small Power Distance: *The extent to which the members of a society accept that power in institutions and organizations is distributed unequally . . . (and) accept a hierarchical order in which everybody has a place which needs no further justification.*

Masculinity versus Femininity: *Masculinity stands for a preference in society for achievement, heroism, assertiveness, and material success. Its opposite, Femininity, stands for a preference for relationships, modesty, caring for the weak, and the quality of life.*

Hofstede's research indicates that lower Uncertainty Avoidance scores will prevail in countries where individuals are very concerned with following rules. So that, "*maintain[ing] rigid codes of belief and behavior and intoleran(ce) towards deviant persons and ideas*" (Hofstede 1984, 83) would be expected in countries with lower Uncertainty Avoidance scores. We also examined the relationships among Hofstede's cultural constructs and Au's data (804) for the European countries in this study. Our analysis indicates that Uncertainty Avoidance is related to Au's pride in work. This should be the case because beliefs about one's job are central to Uncertainty Avoidance (Hofstede 1980, 164). Given Au's findings, we believe that auditors from higher Uncertainty Avoidance countries will be inclined to reveal information that will provide additional information to investors.

Hofstede (1980, p. 214) maintains that concerns about taking care of one's self and family increase with Individualism. Persons from low Individualism countries aspire more to conformity and

orderliness (p. 230), endorse more traditional points of view, frown upon personal initiative (p. 231). Individuals from high Individualism countries believe that policies and practices should allow for a greater degree of individualism (p. 239).

Power Distance negatively associates with freedom in decision-making (Au, 1980). “*People from Large Power Distance societies accept a hierarchical order in which everybody has a place*” (Hofstede, 1984, p. 84) and value obedience and conformity (p. 119). Consequently, auditors from large Power Distance societies should follow the Code of Conduct more rigidly.

In addition, Hofstede (1980, 288) indicates that masculinity is associated with the importance given to achievement and high earnings, femininity is associated with relationships and caring for the weak. Managers in high masculinity societies demonstrate a greater degree of independence and self-realization ideals. So that, as masculinity increases, the importance of career factors and independence will influence auditors’ reasoning. Based on the works of Hofstede, the final two questions asked are:⁵

RQ5: Is there a relationship between Hofstede’s cultural constructs of Uncertainty Avoidance, Individualism, Power Distance and Masculinity and the per country average of the reported probability of the auditor taking the specific action (NSO) noted?

RQ6 Is there a relationship between Hofstede’s cultural constructs of Uncertainty Avoidance, Individualism, Power Distance and Masculinity and the 12 factors (Ri) that the auditors might consider when reaching their audit decision on confidentiality?

⁵ Hofstede, (1991, 112) indicates that his cultural constructs are a “*set of likely reactions of citizens with a common mental programming.*” Because of this, research questions #5 and #6 use the average responses for each country as a parallel construct to Hofstede’s cultural constructs. A personal discussion of the authors with Hofstede indicated that the use of country averages of the responses is the appropriate base for comparison to his country-based construct scores.

RESEARCH DESIGN

Sample Selection

We considered the diversity of accounting systems, cultures, and legal systems of the countries in Western Europe. A system of rules and regulations such as an accounting system is the result of the interactions and compromises among various factors. These factors include the stage of economic development, the nature and development of capital markets, the management and ownership of corporations, providers of capital, the regulatory framework, the status of the accounting profession, and cultural attitudes (Radebaugh 1975).

Because this study concentrates on Western Europe, we were specifically interested in having diversity in the providers of corporate capital, type of tax system, legal systems, and legal and regulatory structure. European countries have historically been financed primarily using either debt or equity. For instance, historically, German firms primarily use debt financing and firms in the UK use equity financing, which suggests different disclosure requirements. Nobes (1998) notes that legal and regulatory systems are important because countries can be differentiated on the basis of their development from either common law (i.e., UK and Ireland) or codified Roman law (i.e., France, Italy, Spain, and The Netherlands). However, tax rules may also influence the development of an accounting system.

We contacted the large international auditing firms in nine European countries. Just prior to starting the sampling, the firms in Germany decided not to participate. The total 287 sample consisted of 25 partners (average in public accounting experience 19.6 years), 61 senior managers (10.4 years experience), 113 managers (7.1 years experience) and 88 seniors (4.5 years experience).

Case Study

In order to avoid using a case study with a simplistic textbook answer, it was necessary to develop a scenario that posed a dilemma to the auditor, one in which there would not be a simple “black-or-white” solution. An original list of eight cases was

developed and pilot tested to determine the reasonableness of each scenario and dispersion of results. Twenty-eight partners and senior managers from regional and national accounting firms in the U.S. took part in the pilot testing.

The authors also sent the scenario and questionnaire to the contact person (i.e., usually the director of human resources or office managing partner) for each firm in the eight countries. These individuals were asked to evaluate the experimental materials. Additionally, senior auditors from the participating countries who were on exchange programs and working in their firms' New York City offices were also asked to read the questionnaire and determine whether it was meaningful in the European context. All of these individuals indicated that the questionnaire was clearly written and that the scenario was valid.

Since the audit scenario presented had an ethical dilemma (i.e. reveal confidential information on one client or express an inappropriate audit opinion on another client), we decided that the 12 factors of consideration to be presented to and evaluated by the subjects should be based on the literature relating to how individuals think about and reason through moral dilemmas. Kohlberg's model of moral reasoning is frequently used in behavioral auditing research (Arnold and Ponemon, 1991; Cohen et al., 1995; Ponemon, 1992; and Ponemon and Gabhardt, 1993). Accordingly, the 12 factors (Ri) selected were designed to range through the spectrum of the various stages of the Kohlberg model and to be presented in a manner similar to those within the related Defining Issues Test developed by Rest (1979).

While the goal of the current research was not to test the moral development stage level of the subjects, the Kohlberg model provided a convenient and appropriate method for selecting a range of considerations within a dilemma situation. As with the case itself, these 12 factors were examined by members of the accounting profession for their reasonableness and completeness. In addition, these factors were examined by others familiar with the Kohlberg model for the accuracy of representation of the various stages in that model. Table 1 shows the average probability

of not signing (NSO) off on a clean audit opinion and the average scores (1 – 7) assigned to each of the 12 Ri's (by country) along with sample size and the Hofstede's cultural constructs.

Distribution and Collection Procedures

The authors asked the contact person in each participating office to determine whether the material distributed to the subjects, including the scenario (see Appendix) and the demographic questionnaires, should be presented in the country's language. The contact persons in Italy and Spain asked that their country's language be used. For these two countries, one person first translated the survey questionnaire into that country's language. A second person translated the questionnaire back into English to ensure that the initial translation correctly reflected the survey's exact intent. All of the individuals who translated the questionnaire data were auditors from Italy and Spain who were on extended exchange assignments in the New York City offices of the firms participating in the study. We checked the accuracy of the interpretations by extensive conversations with the translators.

The lead author visited each office and discussed the questionnaire with the office's Director of Human Resources or the Office Managing Partner who acted as our contact person. These individuals were asked to randomly distribute the surveys to partners, senior managers, managers, and seniors; they collected the completed questionnaires and returned them to the authors.

While we asked that only auditors from the particular country participate in the study, other experiences could influence national traits such as experience in an exchange assignment. To ensure that an individual who had been on an extended assignment outside his/her country were not part of the sample, the authors also included a background questionnaire as part of the survey.

This questionnaire requested information on experience, staff level, age, gender, and nationality. The experience area included a question asking whether the participant had been assigned to an office outside their country for a year or more which ensured the sample represented the culture in that country.

TABLE 1
SAMPLE SIZE AND AVERAGE RESPONSES

Country	N	NSO	R1	R2	R3	R4	R5	R6	R7	R8	R9	R10	R11	R12	UAI	IDV	PDI	MAS
Denmark	40	51%	3.7	4.3	5.9	4.2	6.1	4.1	6.4	5.6	3.5	5.6	3.3	5.6	18	74	18	16
England	37	61%	4.4	3.4	5.5	4.2	6.2	3.9	6.4	5.9	4.3	5.6	4.0	6.1	35	89	35	66
France	19	57%	4.1	4.5	4.2	4.7	4.8	3.8	5.3	5.4	3.3	5.2	4.3	5.5	86	71	68	43
Ireland	36	59%	5.0	3.5	4.6	4.8	6.1	3.7	5.8	5.5	4.8	5.4	4.8	6.3	35	70	28	68
Italy	62	66%	4.0	4.8	5.0	4.3	4.8	4.6	5.4	5.7	3.7	5.7	3.7	5.6	75	76	50	70
Netherlands	33	48%	3.9	4.2	5.5	3.8	5.5	3.8	6.0	5.3	3.5	5.2	3.2	4.8	53	80	38	14
Spain	32	52%	4.9	5.1	4.9	5.3	5.1	4.5	5.9	5.1	4.3	4.7	4.3	5.6	86	51	57	42
Sweden	28	34%	3.9	3.6	5.4	4.0	5.6	4.3	6.1	5.4	4.0	5.3	3.6	5.1	29	71	31	5
Total (Avg)	287	54%	4.2	4.2	5.1	4.4	5.5	4.1	5.9	5.5	3.9	5.3	3.9	5.6	na	na	na	na

ANALYSIS

Using a general linear model, we began the analysis for **RQ1** with an analysis of variance of the NSO scores (the probability that the audit would not sign off on a clean audit report) with the country and staff level being the independent variables. Here we found that there are differences in the means of the NSO scores between countries after accounting for any possible differences in the staff level (partner, senior manager, manager, senior) of the subjects ($p \leq .01$). However, the staff level variable was not significant ($p = .40$), allowing us to combine the scores across all four staff levels. Further analysis indicated that firms were not a significant factor, allowing us to combine the scores from all firms.

TABLE 2
SIGNIFICANCE FOR ANOVA OF NSO SCORES

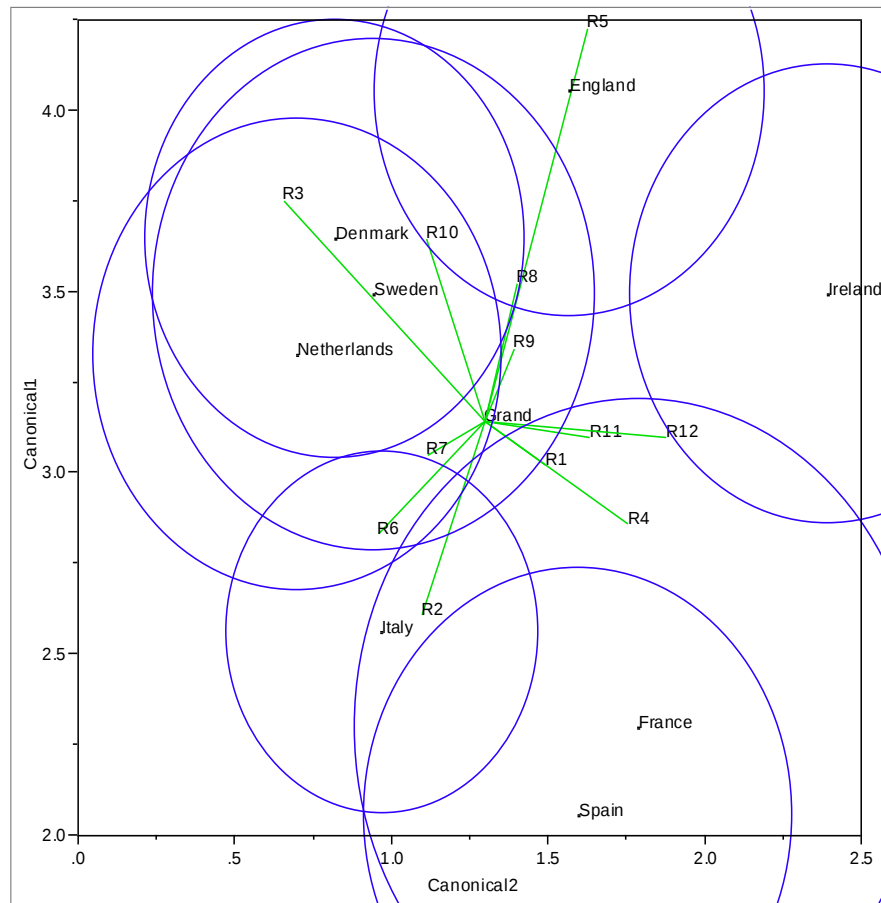
Country	P values
Denmark	Base
England	0.3204
France	0.2253
Ireland	0.1979
Italy	0.0112*
The Netherlands	0.9413
Spain	0.5414
Sweden	0.0222*
* Significant at the .05 level	

Further analysis (Table 2) indicated that the primary source of variation in between-country NSO scores was from Italy ($p = .011$) and Sweden ($p = .022$) with the former producing significantly higher NSO scores and the latter significantly lower NSO scores. Once again, the staff level variable did not significantly influence the results. Using ANOVA, we determined that there were no between-country differences in the within-country distributions of the NSO scores ($p \leq .01$). The Levene test showed that the

variances of the within-country distribution of the NSO were not significantly different from each other.

The analysis for **RQ2** (variance between countries on Ri scores) utilized a MANOVA. Here we examined the scores to the 12 Ri considerations as a set with country and staff level being the independent variables. It was noted, via a Wilks' lambda, Pillai's Trace and Hotelling-Lawley tests, that the country variable was significant ($p = < .01$) but that the staff level variable was not ($p > .72$), allowing us to combine data from all staff levels.

FIGURE 1
CANONICAL CENTROID PLOT OF RI'S BY COUNTRY



With $(R_1, \dots, R_{12})$ as the response vector and Country as the X-factor, we then used the biplot method and contrasts to examine which of these countries are similar and which can be considered different with respect to the R_i scores. The biplot (Figure 1) showed a cluster of three countries, Denmark, The Netherlands and Sweden. Contrasts confirmed that there were no significant differences between these countries ($p = .43, .32$ and $.88$ respectively). Closest to these three countries, as measured by contrasts, was England. It is marginally not different from Denmark ($p = .067$), but is significantly different when the three northern continental countries are combined into one group ($p = .0073$). The biplot indicates that the variable contributing most to their similarity is R_3 , followed by R_4, R_7 . France and Spain are close on the biplot, but the contrast shows them to be significantly different from each other ($p = .0182$). Similarly, France and Italy are different ($p = .0339$). R_4 and R_5 contribute most to their similarity. All other differences are significant ($p < .0001$). Ireland seems to be the most different state on the biplot.

The grouping of the three northern continental countries (Denmark, Sweden and The Netherlands) and the grouping of the three mid- to southern continental countries (Italy, Spain and France) can also be seen by ranking the 12 average R_i scores for these six countries. As seen on Table 3, for seven of the 12 R_i 's, the six rankings for these countries clustered into a perfect north versus south split.

The examination for **RQ3** and **RQ4** (existence of and between-country variation in relationship of NSO and R_i scores) relied upon two step-wise regressions (see Table 4). In the first one addressing **RQ3**, the NSO score served as the dependent variable while the R_i scores were the independent variables. We noted that all but four (R_2, R_4, R_9 and R_{11}) of the 12 R_i considerations were significant at the 0.05 level, providing an R-squared of 0.432. Next we re-ran the step-wise regression adding the country variable (for **RQ4**), observing that the same eight R_i 's were significant and that the country Sweden was added to the model (.01 level, $r^2 = 0.458$).

TABLE 4
STEPWISE REGRESSION OF RI'S WITH NSO SCORES
Independent Variables **P Values from Regressions**

	Without Country	With Country
R1	.0470	.0561
R2	.9712	.6605
R3	.0648	.0460
R4	.1653	.2415
R5	.0000	.0000
R6	.0189	.0092
R7	.0000	.0000
R8	.0002	.0002
R9	.7239	.5386
R10	.0003	.0002
R11	.5901	.6183
R12	.0001	.0002
Denmark	n/a	Base
England	n/a	.1078
France	n/a	.2591
Ireland	n/a	.4200
Italy	n/a	.4130
Netherlands	n/a	.8137
Spain	n/a	.6900
Sweden	n/a	.0005

We ran the step-wise regression on the data for each country with NSO as the dependent variable and Ri's as the independent variables. Table 5 shows a between-countries variation of the significant Ri's, which is likely due to the correlations between the Ri and the small number of observations within each subset.

The fifth research question (**RQ5**) addressed the potential affect of the Hofstede construct scores upon the NSO scores, the Ri scores and the relationship between the two. As noted earlier, because Hofstede's four constructs are country averages, we rely upon the average by country NSO and Ri scores in the analysis.

TABLE 5
STEP-WISE REGRESSION (FORWARD AND BACKWARD) OF NSO BY COUNTRY
(P VALUES OF < .05 SHOWN. ALL OTHERS NOT SHOWN WERE > .05)

	R ²	P values < .05											
<u>FORWARD</u>		R1	R2	R3	R4	R5	R6	R7	R8	R9	R10	R11	R12
Denmark	0.60	.015					.000	.039					
England	0.68				.000			.000	.000				.004
France	0.80	.009						.002	.000	.009	.007		
Ireland	0.50	.007	.021			.001			.002				
Italy	0.39							.044			.049		
Netherlands	0.60			.003		.009	.027		.020				
Spain	0.38						.017			.035			
Sweden	0.64		.007				.010	.007				.040	
<u>BACKWARD</u>		R1	R2	R3	R4	R5	R6	R7	R8	R9	R10	R11	R12
Denmark	0.56						.001	.031					.025
England	0.68				.000			.000	.000			.051	.004
France	0.75							.007	.038				.035
Ireland	0.41							.004			.001		
Italy	0.33							.000			.027		
Netherlands	0.60			.003		.009	.027		.020				
Spain	0.37						.017		.035				
Sweden	0.66	.059			.001							.011	

RQ5 was concerned with the effect of the four Hofstede constructs upon the NSO country averages. Running a stepwise regression (both forward and backward) with the NSO country averages being the dependent variable and the four respective Hofstede construct scores being the independent variable, we observed (with an r-squared of 0.81) that only the masculinity construct was significant ($p \leq .01$) while the other three constructs were insignificant (each with p values of > 0.55). Further evidence of this can be seen when the average NSO of the northern continental European countries (low masculinity countries averaging 11.7 on the Hofstede scale) compared with the average NSO of the mid- and southern continental European countries (high masculinity countries averaging 51.7 on the Hofstede scale). Using a least-squares weighting, the average NSO scores for these two groupings was significantly different (13.8, $p = .0025$).

TABLE 6
REGRESSION OF HOFSTED E CONSTRUCTS AGAINST
AVERAGE RI SCORE BY COUNTRY

Ri	UAI	IDV	PDI	MAS
R1	0.482	0.136	0.653	<u>0.091</u>
R2	<u>0.045</u>	0.935	<u>0.099</u>	0.232
R3	0.410	0.324	0.261	0.296
R4	0.387	<u>0.020</u>	0.394	<u>0.038</u>
R5	0.350	0.732	0.984	0.478
R6	0.571	0.734	0.632	0.924
R7	0.754	0.932	0.831	0.660
R8	0.676	0.163	0.881	0.178
R9	0.345	0.157	0.646	0.101
R10	0.945	0.185	0.675	0.320
R11	<u>0.090</u>	<u>0.046</u>	0.108	<u>0.030</u>
R12	0.161	0.112	0.448	<u>0.008</u>
<u>Significant at the .10 level</u>				

RQ6 addressed the effect of the constructs upon the 12 Ri country averages. Since we were forced to use country averages

for the 12 Ri's, we did not have enough data points to analyze the effect of the construct scores on the entire set of Ri's. Instead, we were forced to regress each individual Ri with the four country specific construct scores. Here we see (Table 6) that for four of the 12 Ri's (R1, R4, R11 and R12), the Masculinity construct was significant at the .10 level.

However, for the other constructs, only random significance was observed (UA for R2 and R11, IND for R4 and R11 and PD for R2). In addition, we regressed the country NSO scores against masculinity score and each individual Ri. In each case, the masculinity score was significant (as anticipated from earlier analysis) but only one of the R scores (R9) proved to also be significant ($p = .031$).

In summary, we observed that:

- **(RQ1)** while no significant differences exists in a comparison of "within-country distributions", we do see variation across countries in the average NSO responses, with Sweden and Italy providing the greatest source of this variation, as well as a moderate amount of clustering of northern continental and mid- and southern continental European countries.
- **(RQ2)** while we see considerable variation between countries in the relative importance of the 12 Ri factors, certain patterns did emerge. The northern continental European countries (Denmark, Sweden and The Netherlands) displayed similarities, especially in three of the Ri (R3, R4 and R7) while the mid- to southern most countries displayed a small but not significant amount of similarity. Ireland proved to be the most different.
- **(RQ3 and RQ4)** while there is a relationship between a number of the Ri factors and the NSO scores for the population as a whole and for each individual country, we did not observe any consistent between-country patterns at to which of those specific Ri factors were the most significant.

- **(RQ5 and RQ6)** only the Masculinity construct provided significance, being associated with both the NSO scores and with four of the 12 Ri factors. Furthermore, the north vs. mid- and southern continental country split noted in the **RQ2** analysis provides a consistent dichotomy, indicating that the cause of variation in the Ri's could be attributable, in part, to one of the cultural constructs.

CONCLUSIONS

In summary, we do see enough between-country variation for the one scenario presented in this research to question whether the universal principle of confidentiality is being applied consistently across European countries. Furthermore, we see considerable variation in the relative importance assigned to the various factors taken into account by the participants when reaching their decisions regarding the confidentiality principle. And we also see some dependence in the assignment of importance of these factors upon the cultural construct of masculinity. We believe that these findings will have significance for the users of financial statements, for the standard settings boards as they develop programs and directives of mutual recognition and for the international accounting firms as they review their auditing programs and promotional material.

Once these findings are combined with others that also found between-country culturally-dependent variations in auditors' approaches and techniques to problem solving (e.g. Arnold, et al. 1999a and 1999b regarding auditor independence; Arnold, et al. 2001a and 2001b regarding materiality estimates and Arnold, et al. 2002 regarding premature audit sign off and "eating time"), one must continue to question the potential for a reasonable amount of uniformity on other more complex accounting and auditing principles. Yet the advocacy for the concept of mutual recognition of accounting and auditing principles, as well as the "one-firm-worldwide" claims of the international accounting firms, squarely rests upon the ability of the accounting professional to provide a relatively uniform and consistent audits in multiple international

settings. The lack of such a cornerstone would have potentially devastating effects upon the believability and reliability of the financial reports.

The findings would suggest the potential for undesired consequences of a rush toward between-country acceptance of accounting and auditing principles. It would also suggest that the international accounting firms re-examine the effectiveness of their claim of uniformity of auditing services throughout the world.

We must be very careful in attempting to draw too many conclusions from a limited one case scenario study. However, considerable evidence is building through the current and prior studies cited above. Thus the need for concern is growing. These findings indicate a strong need for continued exploration of potential differences in the application of other principles of accounting and auditing, drawing upon a greater number of countries and multiple audit scenarios for each principle.

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APPENDIX

CONFIDENTIAL INFORMATION

An auditing firm serves as the auditor for both Client A and Client B. Client A, a major employer in an economically depressed small town, receives a major portion of its business from a contract with Client B. Client A has been in financial difficulty for a number of years and its financial viability is in question. If it ever became evident that Client A would lose the contract with Client B, the auditing firm would probably issue an opinion that expresses the auditor's DOUBT about Client A's ability to STAY in business.

Client A has been putting forth a major effort to find new customers to supplement its business and has begun to achieve some success. They are currently negotiating a significant loan from a local bank. While this bank realizes that the loan would be risky (especially for a small town bank of its size) and would have serious implications for its own financial position if the loan defaulted, they are proceeding with it because they believe that they have an obligation to the local community. The bank will not give the loan however until they have a chance to look at this year's audited financial statements for Client A. After reviewing the unaudited preliminary information, the bank indicated that the loan will be granted if Client A receives a "clean audit opinion".

While auditing Client B (a larger company in another city) Mary, the audit partner on both client engagements, discovers that Client B will not be renewing its contract with Client A. Mary realizes that when Client A loses the contract, it will probably be forced into bankruptcy. However, Client B will not be disclosing this information until after the audit report of Client A must be signed. Mary is confident that Client A does NOT know of this upcoming disaster and further audit work would not disclose it. Mary discusses the problem with Client B's president who firmly states that this information is not to be revealed at this time. Client B has been an audit client for a number of years. Recently, Mary's firm has been attempting to generate some consulting engagements with Client B.

It becomes obvious that if Mary issues a “going concern opinion” for Client A, it would be equivalent to divulging private information. Client B might be lost as a client. However, if Mary does not divulge the information, the bank will make the loan with the full impact on the bank and community.

QUESTIONS:

What is the probability (0 to 100%) that Mary **WILL REFUSE** to sign a “clean audit opinion? _____ %

How important do you think that each of the following factors would be to Mary when she makes her decision regarding the confidential information for EACH of the 12 factors listed below (circle a number for each factor)? (Where: 1 = Very Unimportant and 7 = Very Important).

1. The effect on the continuing relationship with Client B even if Mary’s firm does not lose them as a client.
2. The auditor should always provide information that allows the financial community to operate efficiently.
3. The financial community’s dependence on auditors to follow the rules of professional conduct.
4. The potential loss of firm’s reputation with the bank.
5. The potential legal retribution for confidentiality violation.
6. The fairness of allowing the bank and community to suffer potential loss because of auditing rules.
7. The code of professional conduct regarding the confidentiality of information.
8. Audit rules regarding the consideration of all known information.
9. The loss of personal reputation within the firm.
10. The truthfulness of the auditor’s report in relation to the facts of the case.
11. Fear of losing Client B.
12. Possible legal action against the firm.

NOTE: Each of the 12 considerations included a seven-point Likert scale:

