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Discussion of Arnold, Bernardi, and Neidermeyer "The association between European materiality estimates and client integrity, national culture and litigation"

Ananda R. Ganguly*, Cynthia W. Turner

Department of Accountancy, University of Illinois, 389 Wohlers Hall, 1206 South Sixth Street, Champaign, IL 61820, USA

1. Introduction

Arnold, Bernardi, and Neidermeyer (2001) examine the differences in materiality-threshold estimates among auditors from seven European countries, and also compare their estimates with those of a group of auditors from the US. An investigation of this nature is important, in general, for at least two reasons. First, the International Accounting Standards Committee (IASC) has set forth as one of its goals, "the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements" (IASC, Sect. 9000A, para 2, 1992). Accounting research suggests that one likely factor that precipitates differences in accounting practices across countries is the culture of the country in which the practitioner operates (Wingate, 1997). Thus, the study of materiality estimates among auditors in different economic-accounting regimes of the world provides insight into likely inconsistencies accountants should consider if they are to proceed towards this stated goal of the IASC. Second, such an examination enhances the profession's ability to recognize generally accepted accounting and auditing practices of different economic-accounting regimes across the world.

More specifically, it is important for us to understand two different things: (1) how materiality-threshold judgments and decisions are affected by *personal* characteristics of auditors such as their risk preferences, accounting conservatism, professional skepticism, knowledge, cognitive ability, and information-processing biases, etc., and *environmental* factors such as incentives, disincentives, frequency of litigation, and accounting regulation,

* Corresponding author. Tel.: +1-217-244-0532.
E-mail address: aganguly@uiuc.edu (A.R. Ganguly).

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etc.; and (2) how any of these personal characteristics and environmental factors tend to differ among different cultures and subcultures that produce the auditors (who make these materiality-threshold judgments on companies they audit).

This paper is an interesting attempt at studying some of these impacts on Big Six auditors' materiality-threshold estimates. It would appear at first glance that the authors try to operate within the first of the above two lines of inquiry. We say this because they have relied on previous research (primarily Hofstede, 1980, 1991; Wingate, 1997) to make assumptions on how personal characteristics of auditors and environmental factors tend to differ among different cultures and subcultures. However, if their research objectives have to do with the impact of different personal characteristics and cognitive abilities on materiality-threshold judgments and decisions, then the appropriate experiment seems to be to manipulate or measure these personal characteristics directly and study their impact on materiality thresholds. Either materiality-threshold-related judgments or the threshold-estimate decisions could then be studied, depending on the aspect of the decision-making process upon which the researchers wished to concentrate.

As it stands, the authors have conducted an experiment on the impact of low and high client integrity on materiality-threshold estimates in seven European countries (with the United States as a benchmark). In doing so, they have assumed that personal and environmental characteristics measured in previous cross-cultural research generalize to auditors studied in the current experiment. Thus, the authors have effectively conducted a single experiment collapsing across the two lines of inquiry outlined above.

2. Theory and design

Of course, joint tests sometimes do suffice, but in the case of this study, they raise concerns on the validity of different cause–effect relationships. To understand these concerns, let us first begin with a summary of the design. The authors presented experienced auditors from different countries with a questionnaire in which these subjects had to make an estimate of how large an error in the inventory account needed to be before it was considered material (i.e., the smallest size to be material). The subjects were asked to make this materiality-threshold estimate after reading a short analysis of the client's integrity level as compared to the entire population of potential clients of the firm. The hypotheses (relating to the impact of culture on materiality-threshold judgments) were then tested essentially by running regression models with the materiality-threshold estimate as the dependent variable and the following three explanatory variables: (1) client integrity (2) uncertainty avoidance in the culture, and (3) litigation. The client integrity variable was manipulated at two levels: high or low. This was between subjects. That is, each subject got a questionnaire describing the client either as being of high integrity or as being of low integrity, and no subject was presented with both conditions sequentially. Uncertainty avoidance and litigation measures for the different countries were obtained from previous research or independent measurement. We discuss our concerns with these two variables in detail below.