Understanding financial accounting practice

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Abstract

In introducing three papers on the institutionalised nature of financial accounting practices, this paper argues for the importance of research that can provide more adequate insights into the wider institutional and social positioning of financial accounting. Illustrating the argument by appeal to both contemporary and earlier examples, emphasis is placed on the ways in which changes in the wider interests in and around the enterprise can and do mediate financial accounting practice. © 2000 Published by Elsevier Science Ltd.

1. Introduction

The institutional and social aspects of financial accounting are still relatively unexplored. Compared with our insights into the economic theory of income calculation and the economic determinants and consequences of modes of corporate financial reporting, our knowledge of how forms of financial accounting emerge from, sustain and modify wider institutional and social structures is modest.

One illustration of this is in the area of comparative or international financial accounting. At the very time when there are enormous pressures for the harmonization or standardization of forms of financial accounting, our insights into the factors resulting in earlier differences in such practices are still poorly developed. Of course in a large part the interest in understanding both earlier and existing patterns of difference emerged from those very pressures for international similarity. As a global perspective on financial accounting started to emerge, patterns of difference started to be identified and made into objects of analysis. However, with the benefit of hindsight, too much emphasis seems to have been put into mobilising too simplistic theories of differentiation, too deep rooted notions of cultural understanding and too psychologistic appreciations of institutional differences. The result is that after years of effort, we still have poor accounts of the factors implicated in accounting differentiation and the pressures for this to change.

The limitations in our understandings can be seen in many areas of current accounting policy making at the international level. Why has there been such a sudden rush to standardise previously disparate modes of financial accounting? Is it solely a functional reflection of the internationalisation of financial markets, or are other factors at stake? Is financial accounting not only a functional artifact but also in many contexts a cultural symbol of modernity and marketisation and thereby subject to cultural, economic and institutional pressures and influences? Reflect also on the sheer pace of change in some areas of financial accounting. Many prevailing understandings had emphasised the deep rooted cultural and historical groundings of contemporary practices. Studying the ancestry of present forms of financial accounting, emphasis had been placed on the substantive nature of their involvement with
specific legal, regulatory and organizational structures. The expectation seemingly was one of long standing difference, something which made it even more difficult to appreciate the apparent speed of calculative change in some national contexts.

Consider the case of Germany. Existing conceptual understandings have emphasised the cultural specificity of financial accounting in Germany. The practices were understood in relation to different forms of corporate governance, capital market functioning and legal modes for regulating accounting. Such differences were reinforced by differences in occupational structures, forms of education and training, and the ways in which accounting knowledge was conceptualised and modified. All of these factors suggested a pattern of deep rooted difference and one that was difficult to change. But then German accounting started to change and has subsequently demonstrated, at least in part, an openness to change that many would have thought impossible given previous understandings of the ways in which the financial accounting practices were embedded in the wider institutional context. Be that as it may, in a comparatively short period of time, legislative, institutional, regulatory and legal changes have been put into motion that have started to make German accounting what it was not. Most current appreciations of the institutional and social embeddedness of financial accounting make that difficult to appreciate.

Such difficulties need to be responded to positively, however, and used as a basis of taking our knowledge of accounting forward. How is it that change can seemingly emanate so rapidly from what were perceived to be such stable structures?

On reflection, previous understandings of the institutional and social nature of financial accounting practice suffered from a number of problems.

2. Too nationally focused

From ancient times onwards, accounting knowledges and practices have moved and changed. Relying particularly on the diffusing potential of both markets and empires, accounting practices and practitioners have travelled along market routes and followed colonial powers. Much of the contemporary landscape of accounting reflects these tendencies, although they are still inadequately studied. In the present context they suggest that caution is required when focussing exclusively on only national determinants of financial accounting practices. They also point to continuities between the past and present as far as the histories of accounting movement and standardisation are concerned.

3. Too much emphasis on national accounting homogeneity

In practice, in most countries, diverse forms of accounting are practiced within national boundaries. Not only is this the case for public and private sector accountings, but also within the private sector, diverse modes of accounting co-exist. Often these reflect differences in size and capital market orientation. Take financial accounting in the United Kingdom as an example. Whilst capital market orientations might have resulted in concerns with creative and profit enhancing accountings amongst many quoted companies, for smaller enterprises more cautious modes of accounting are much more typical. The latter often reflect concerns with creditors, banks and the tax authorities. In many respects small firm accounting in the United Kingdom has many of the characteristics conventionally associated with financial accounting practices in Germany, suggesting that the more specific and local institutional configurations around the reporting entity might be more important determinants of practice than more distant and general national factors.

4. Insufficient attention given to the actual practices of financial accounting

If, for example, more empirically grounded investigations had been made of, say, British financial accounting, the diversity of practices would have been revealed, including those that stand in contrast with the prevailing national
stereotype and identity of “true and fair accounting”. Such more empirically grounded investigations might also have pointed to the complex and highly ambiguous relationship between the practices of financial accounting and the national representations of them. Such national accounting identities, where they exist, may have their own quite distinct origins, often at a distance from the practice of the accounting craft and usually reflecting the pressures of international accounting politics rather than purely national concerns. When seen in this way, grounded empirical observations might well have revealed the differences between accounting in Britain and the more abstract notions of British accounting. One senses that too much comparative accounting research has concerned itself with national accounting identities rather than the national practices of accounting.

5. Too abstract characteristics of national difference

Whether conducted in terms of rather gross and usually highly questionable comparisons of the differential roles played by states and markets or more psychologically oriented characterisations of national attitudes and behaviours, many, if not most, such analyses have given comparatively little consideration to the actual practice of accounting, based on grounded empirical and historical enquiries into accounting as it is, rather than as it is assumed to be.

The potential for a serious institutional and social analysis of financial accounting is to move beyond such problems. Requiring both conceptual and theoretical sophistication and a detailed insight into and appreciation of financial accounting in practice, such an analysis of financial accounting offers the potential to understand more adequately the factors implicated in difference, change and consequences.

To give an insight into what such an analysis might offer, reflect again for a moment on recent developments in financial accounting and its regulation in Germany. Compared with existing institutional and social characterisations of the practice of German financial accounting which had emphasised its deep rooted determinants and profound cultural interdependency, observations of practice have revealed an amazing speed of change — change in both reporting practices within the context of the quite considerable discretion provided within the law and change in the regulatory structures associated with the financial accounting craft. So rather than looking for theories of stability and permanence, we need insights into the means by which at least certain German accounting practices can respond rapidly to contextual change. Attention needs to be focused on the location and mobilisation of accounting discretion, on the linkages between corporate financial officers, auditors and officials in regulatory agencies, and on the ways in which notions of good accounting emerge, are propagated and change.

Such a German example could easily stimulate an awareness of the relative rapidity of other financial accounting changes:

- In post World War II Netherlands where a new socio-political consensus faced an industrial sector newly emergent from involvement in the war. In such a setting — and that of numerous other European countries at the same time — the social meaning of profit was being redefined, as were the expectations for its distribution on the part of those parties who perceived themselves to have an interest in the enterprise. In The Netherlands, managers in some major enterprises started to experiment with advancing the legitimacy of new theorisations of accounting that resulted in lower reported surpluses, smaller corporate distributions and the maintenance of funds within the enterprise for investment purposes. Notions of the appropriateness of replacement cost accounting may have had purely academic origins but they were mobilised in the highly specific socio-institutional setting illustrating the ways in which calculations of corporate surplus could respond to changes in the relative power of the social interests in and around the enterprise. In France similar
technical changes were, for a time, achieved by modifications in the tax code, there also in the name of maintaining a greater proportion of surpluses in the enterprise for investment purposes.

- The potential for similar changes in the calculation of corporate surplus occurred during the early days of a new Labour Government in Britain in the early 1970s. Fearing a period of heightened trade union power, corporate management quickly demonstrated a newly found interest in means of reducing rather than enhancing corporate profitability. For a time, doing this in the name of truth of newly rearticulated theories of inflation accounting seemed to be attractive, with even The Financial Times seeing this as the anorexia of British industry. But as the fear of a new and different power structure around the enterprise passed, so did the interest in recalibrating the measurement of the financial performance of enterprises.

Such examples point to the repeated speed with which modes of financial accounting can and do change. Even in a particular national setting and even when many of the seemingly important determinants of national practices of financial accounting remain largely unchanged, it would appear that the determination of corporate surplus and the accounting practices and bodies of knowledge implicated in this can and do respond with quite surprising speed to shifts in the configuration of socio-economic interests in and around the enterprise. Appeals to notions of corporate governance and understandings of the roles which alternative governance structures might play in influencing accounting arrangements go some way to addressing such issues. But it would appear that the notion of corporate governance is a rather partial one for this purpose, emphasising a corporatist view of the figuration of influences within the enterprise and paying little or no attention to the less institutionalised but no less important pressures that can impinge on the enterprise.

Taking such understandings forward will require a great deal of research, empirical, historical, comparative and theoretical. Indeed this might be one area where very different approaches might have the potential to provide a more integrated view of the entwinement of financial accounting practices in the institutional configurations that surround the enterprise. Analytical investigations of optimal modes of surplus declaration in multiple interest settings might well have the ability to cast light on the observations emerging from historical, comparative and contemporary inquiries.

The papers that follow seek to probe into fundamental aspects of the practice of financial accounting in the way outlined above. McSweeney focuses on the fundamentally ambiguous and constructivist nature of accounting practice. Taketera and Sawabe propose an institutional analysis of financial accounting practice that casts light on the institution building nature of accounting and the ways in which it mediates the relationships between the enterprise and its stakeholders. In an intriguing analysis deriving from the Italian Economia Aziendale tradition of scholarship, Zambon and Zan offer an insight into how knowledges of both the firm and accounting mediate the practice of accounting. They illustrate their analyses with an example showing how notions of calculated surplus are dependent on the social constitution and governance structure of the enterprise. All three analyses point to the enormous potential for such investigations in the financial accounting area.